SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1954

No. 417

LEWYT CORPORATION (NOW KNOWN AS LEWYT MANUFACTURING CORPORATION), PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1954

No. 417

LEWYT CORPORATION (NOW KNOWN AS LEWYT MANUFACTURING CORPORATION), PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED OCTOBER 20, 1954

CERTIORARI GRANTED DECEMBER 6, 1954

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BEFORE THE TAX COURT OF THE UNITED STATES

EXHIBIT A, ANNEXED TO PETITION—Filed May 8, 1950

Treasury Department
Internal Revenue Service

Office of
Internal Revenue Agent in Chicago
Brooklyn Division
One Hanson Place
Brooklyn 17, New York

February 16, 1950

Lewyt Corporation
60 Broadway
Brooklyn 11, New York

Gentlemen:

You are advised that the determination of your income tax liability for the taxable year ended September 30, 1944, discloses a deficiency of $7,129.21, and that the determination of your excess profits tax liability for such year discloses an overassessment of $6,443.59, and that the determination of your income tax liability for the taxable year ended September 30, 1945, discloses an overassessment of $4,151.49, and that the determination of your excess profits tax liability for such year discloses a deficiency of $428,288.05, as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the Tax Court of the United States, at its principal address, Washington 25, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Brooklyn, New York for the attention of SAD:90D. The signing and filing of this form

will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest [fol. 14] period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Very truly yours, Geo. J. Schoeneman, Commissioner, By (Signed) E. X. Kelly, Acting Internal Revenue Agent in Charge.

Enclosures:
Statement
Form of Waiver, Forms 843
MRW: MEV

Statement

LEWT CORPORATION
60 Broadway
Brooklyn 11, New York

Tax Liability for the Taxable Years Ended September 30, 1944 and September 30, 1945

Year	Liability	Assessed	Over-assessment	Deficiency
		Income Tax		
9/30/44	$ 35,712.34	$ 28,583.13	.....	$ 7,129.21
9/30/45	20,318.49	24,469.98	$4,151.49	.....
		Excess Profits Tax		
9/30/44	$280,540.33	$286,983.92	$6,443.59	.....
9/30/45	192,810.61	(235,477.44)	.....	$428,288.05

In making this determination of your income tax and excess profits tax liabilities, careful consideration has been given to the report of examination dated July 26, 1948; to your protest dated October 22, 1948; and to the statements made at the conferences held on November 18, 1948 and May 17 and September 19, 1949.

[fol. 15] It is held that since your records are maintained, and your Federal income and excess profits tax returns are filed, on the accrual basis, taxes referred to in section 122(d)(6) of the Internal Revenue Code may be allowed as a deduction only to the extent that they accrued within the taxable year in determining your net operating loss deductions. Therefore, your contention that $625,640.60 and $298,538.61 should be allowed as deductions in determining

the net operating loss for the years 1946 and 1947, respectively, has been denied.

It is held also that Federal income and excess profits taxes accrue on the last day of the year for which assessed and therefore must be eliminated from the surplus account as of the beginning of the following year for the purpose of determining your equity invested capital. Therefore your contention that your surplus as of the beginning of the taxable years in question should not be reduced by additional income and excess profits taxes in controversy until such controversy has been terminated has been denied.

It is further held that excess profits disclosed by the renegotiation of war contracts never represented income for the years for which determined and consequently should not have been included in surplus. Your contention, therefore, that excess profits resulting from the renegotiation of war contracts should not be excluded from invested capital until finally determined, has also been denied.

The overassessments shown herein will be made the subject of certificates of overassessment which will reach you in due course through the office of the collector of internal revenue for your district, and will be applied by that official in accordance with section 322(a) of the Internal Revenue Code, provided that you fully protect yourself against the running of the statute of limitations with respect to the apparent overassessments referred to in this letter, by filing with the collector of internal revenue for your district, claims for refund on Form 843, copies of which are enclosed, the basis of which may be as set forth herein.

[fol. 16] A copy of this letter and statement has been mailed to your representative, Mr. Victor I. Seidman, 285 Madison Avenue, New York, N. Y., in accordance with the authority contained in the power of attorney executed by you.

Taxable Year Ended September 30, 1944
Adjustments to Net Income

Net income as disclosed by amended return		$ 747,236.60
Unallowable deductions and additional income:		
(a) Capital expenditures	$ 8,637.07	
(b) Entertaining expenses	3,943.46	
(c) Bad Debts	13,280.35	
(d) Officer's salary	13,000.00	
(e) Net operating loss carry-over	70,444.30	
(f) New York State franchise tax	24,416.76	
(g) Cost of goods sold	145,118.14	278,840.08
Total		$1,026,076.68
Nontaxable income and additional deductions:		
(h) Depreciation	$ 355.09	
(i) Amortization of emergency facilities	21,770.00	
(j) Capital stock tax	12,500.00	
(k) Termination claim	8,614.78	
(l) Renegotiation of war contracts	397,970.00	
(m) Net operating loss carry-back	164,326.38	605,536.25
Net income for declared value excess profits tax computation, adjusted		$ 420,540.43

[fol. 17] Explanation of Adjustments

(a) Repairs claimed per return	$33,056.61
Allowed	24,419.54
Disallowed	$ 8,637.07

To the extent disallowed the amount represents capital expenditures that are not deductible under the provisions of Section 24(a) of the Internal Revenue Code.

(b) Entertaining expense of $3,943.46 claimed among the deductions that are on the return are disallowed for lack of substantiation and failure to meet the other requirements of Section 23(a) of the Internal Revenue Code.

(c) Bad debts claimed per return	$26,560.69
Allowed	13,280.34
Disallowed	$13,280.35

To the extent disallowed the amount represents an excessive addition to the reserve for bad debts which is not allowable under the provisions of Section 23(k) of the Internal Revenue Code.

(d) It is held that a reasonable allowance for compensation for personal services actually rendered by Mrs. Madge Ferredy does not exceed $12,000.00 for the taxable year. The amount of $25,000.00 deducted in your return is accordingly disallowed to the extent of $13,000.00

(e) Net operating loss carry-over of $70,444.30 claimed from the taxable year December 31, 1942 to September 30, 1943 is disallowed since it has been determined that you realized a net profit in such year in lieu of the loss claimed.

(f) An excessive deduction of $24,416.76 for New York State franchise tax is disallowed, $136,098.91 having been deducted in the return, whereas liability was incurred during the taxable year in the amount of $111,682.15.

[fol. 18](g) The value of unfilled war contracts and orders, acquired from Alexander M. Lewyt and Madge Ferredy on December 31, 1942, has been determined to amount to $84,328.25 of which $51,954.63 was allowed as a part of the cost of goods sold for the taxable year December 31, 1942 to September 30, 1943 which was agreed to by you. Accordingly, the balance of $32,373.62 is allowed as a part of the cost of goods sold in this year in lieu of the $177,491.76 claimed in your return.

(h) An additional depreciation deduction of $355.09 has been allowed.

(i) An additional deduction of $21,770.00 has been allowed for amortization of emergency facilities.

(j) An additional deduction of $12,500.00 has been allowed for Federal capital stock tax.

(k) Payment of $8,614.78 made by you on termination claim in the year ended September 30, 1946 has been determined to be deductible in this year.

(l) To reduce net income per return by the amount of excessive profits arising from renegotiation of war contracts.

(m) A net operating loss carry-back of $164,326.38 has been allowed from the year ended September 30, 1946 as shown below under Adjustments to Net Income.

Income Tax Computation

	Applicable to Calendar Year 1943	1944
Net income for declared value excess profits tax computation, adjusted	$420,540.43	$420,540.43
Less: Declared value excess profits tax	none	none
Net income	$420,540.43	$420,540.43
Less. Income subject to excess profits tax as shown below	335,002.76	330,002.76
[fol. 19] Normal tax net income and surtax net income	$ 85,537.67	$ 90,537.67
Normal tax at 24%	$ 20,529.04	$ 21,729.04
Surtax at 16%	13,686.03	14,486.03
Total normal tax and surtax	$ 34,215.07	$ 36,215.07
Tentative tax 1943—$34,215.07 x 92/366		$ 8,600.51
Tentative tax 1944—$36,215.07 x 274/366		$ 27.111.83
Income tax liability		$ 35,712.34
Assessed: Original, Acc't 416533, Feb. 1945 (3rd N. Y.)		28,583.13
Deficiency of income tax		$ 7,129.21

Adjustments to Excess Profits Net Income Computed Under Invested Capital Credit Method

Excess profits net income as disclosed by amended return	$757,408.69
Addition:	
(a) 50% of interest on borrowed capital for year ended September 30, 1946	8,076.26
Total	$765,484.95

Deduction:	
(b) Net decrease in net income as shown under adjustments to net income above	326,696.17
Excess profits net income adjusted	$438,788.78

Adjustment to Excess Profits Credit
Based on Invested Capital

Invested capital as disclosed by amended return	$957,873.90
Deduction:	
(a) Accumulated earnings and profits	306,834.76
Invested capital as adjusted	$651,039.14

[fol. 20] Explanation of Adjustment

(a) Accumulated earnings and profits at beginning of taxable year per return	$306,834.76
As corrected	none
Adjustment shown above	$306,834.76

Computation of Excess Profits Credit Based on Invested Capital

Invested capital as adjusted	$651,039.14
Excess profits credit (8% of $651,039.14)	52,083.13

Excess Profits Tax Computation

	Applicable to Calendar Year 1943		1944	
Excess profits net income based on invested capital as shown above		$438,788.78		$438,788.78
Less: Specific exemption	$ 5,000.00		$ 10,000.00	
Excess profits credit based on invested capital as shown above	52,083.13		52,083.13	
Unused excess profits credit from year ended Sept. 30, 1946 as shown below	46,702.89	103,786.02	46,702.89	108,786.02
Adjusted excess profits net income		$335,002.76		$330,002.76
1943—90% of $35,002.76		$301,502.48		
1944—95% of $330,002.76				$313,502.62
Surtax net income (before Sec. 26 (e) credit)	$420,540.43		$420,540.43	
80% of $420,540.43	$336,432.34		$336,432.34	
Less normal tax and surtax as shown above	34,215.07		36,215.07	
Difference		$302,217.27		$300,217.27
Applicable excess profits tax		$301,502.48		$300,217.27
Tentative tax 1943 ($301,502.48 x 92/366)				$ 75,787.47
Tentative tax 1944 ($300,217.27 x 274/366)				224,752.86
Excess profits tax				$300,540.33
Less: Credit for debt retirement				20,000.00
Excess profits tax liability				$280,540.33
Assessed: Original, Acc't. # 407342, Feb. 1945 (3rd NY)			$605,561.59	
Less: Credit allowed under Sec. 3806 (b)			318,577.67	286,983.92
Overassessment of excess profits tax				$ 6,443.59

[fol. 21] Post-War Refund of Excess Profits Tax and Credit for Debt Retirement

Excess profits tax before credit for debt retirement		$ 300,540.33
Credit allowable under sections 780 and 781 (10% of $300,540.33)		$ 30,054.03
Reduction in indebtedness	$ 50,000.00	
Credit for debt retirement (40% of $50,000.00		20,000.00
Net post-war refund credit		$ 10,054.03

Taxable Year Ended September 30, 1945
Adjustments to Net Income

Net income as disclosed by return		$1,215,320.25
Unallowable deductions and additional income:		
(a) Capital expenditures	$ 17,157.59	
(b) Entertaining expenses	2,773.37	
(c) Bad debts	12,287.34	
(d) Termination claims	108,453.87	
(e) Officer's salary	13,000.00	
(f) New York State franchise tax refund	53,607.79	
(g) Contributions	20,005.42	227,285.38
Total		$1,442,605.63

Nontaxable income and additional deductions:		
(h) Depreciation	$ 3,067.15	
(i) Renegotiation of War contracts	327,052.00	
(j) Net operating loss carry-back	786,383.25	
(k) New York State franchise tax	43,233.98	1,159,736.38
Net income for declared value excess profits tax computation, adjusted		$ 282,869.25

[fol. 22] Explanation of Adjustments

(a) The amount of $17,157.59 representing capital expenditures, included among the deductions on the return, is disallowed in accordance with the provisions of section 24 (a) of the Internal Revenue Code.

(b) Entertaining expenses of $2,773.37 included among the deductions on the return are disallowed for lack of substantiation and failure to meet the other requirements of section 23 (a) of the Internal Revenue Code.

(c) Bad debts claimed per return		$ 24,574.68
Allowed		12,287.34
Disallowed		$ 12,287.34

To the extent disallowed the amount represents an excessive addition to the reserve for bad debts which is not allowable under the provisions of section 23 (k) of the Internal Revenue Code.

(d) The amount of $108,453.87, representing reimbursements received by you in the year ended September 30, 1946 by reason of the termination of government contracts, is held to constitute taxable income in this year, the year in which the value of your claims was determined, under the provisions of section 42 of the Internal Revenue Code since your returns are rendered on the accrual basis.

(e) It is held that a reasonable allowance for compensation for personal services actually rendered by Mrs. Madge Ferredy does not exceed $12,000.00 for the taxable year. The amount of $25,000.00 deducted on your return is accordingly disallowed to the extent of $13,000.00.

[fol. 23] (f) It is held that a refund of New York State frachise tax to you constitutes taxable income in this year in the amount of $53,607.79, determined as follows:

Net income for year 1942 before renegotiation adjustment	$1,861,369.24	
6% of above		5 111,682.15
Net income after renegotiation adjustment	$ 822,369.24	
6% of above		49,342.15
Difference		$ 62,340.00
Amount of New York State franchise tax allowed as a credit by Renegotiation Board	$ 58,074.36	
Less: New York State franchise tax after renegotiation adjustment	49,342.15	8,732.21
Adjustment shown above		$ 53,607.79

(g) An excessive deduction for contributions of $20,005.42 is disallowed, determined as follows:

Net income per return		$1,225,641.63
Add: Contributions deducted per return	$ 35,436.50	
Adjustments (a) to (f), inclusive above	207,279.96	242,716.46
		$1,468,358.09
Less: Adjustments (h) to (k), inclusive, below		1,159,736.38
Revised net income before deduction for contributions		$ 308,621.71
Contributions allowable (5% of $308,621.71)		$ 15,431.08
Contributions deducted per return		35,436.50
Adjustment shown above		$ 20,005.42

[fol. 24] (h) An additional depreciation deduction of $3,067.15 has been allowed.

(i) To reduce net income per return by the amount of excessive profits arising from renegotiation of war contracts.

(j) A net operating loss carry-back of $786,383.25 has been allowed from the year ended September 30, 1947 as shown below under Adjustments to Net Income.

(k) An additional deduction of $43,232.98 has been allowed for New York State franchise tax.

Income Tax Computation—Alternative Tax

Net income for declared value excess profits tax computation adjusted		$ 282,869.25
Add: Long-term capital gain		10,321.38
Total		$ 293,190.63
Less: Declared value excess profits tax		none
Net income		$ 293,190.63
Less: Long-term capital gain		10,321.38
		$ 282,869.25
Less: Income subject to excess profits tax as shown below		237,136.90
Balance subject to normal tax and surtax		$ 45,732.35
Normal tax computation:		
$5,000.00 at 15%	$ 750.00	
15,000.00 at 17%	2,550.00	
5,000.00 at 19%	950.00	
20,732.35 at 31%	6,427.03	$ 10,677.03
Surtax computation:		
25,000.00 at 10%	$ 2,500.00	
20,732.35 at 22%	4,561.12	7,561.12
[fol. 25] Partial tax		$ 17,738.15
25% of long-term capital gain		2,580.34
Income tax liability		$ 20,318.49

Assessed:		
Original, Acc't #415100, May 1946 (3rd N.Y.)	$ 23,715.48	
Additional, Jan. 15, 1948, Spl. No. 12, Page 0, Line 2C	1,683.42	
Overassessment, Sch. No. IT:CB:7136 Suppl.	(928.92)	24,469.98
Overassessment of income tax		$ 4,151.49

Adjustment to Excess Profits Net Income Computed Under Invested Capital Credit Method

Excess profits net income as disclosed by return		$1,236,903.81
Addition:		
(a) 50% of interest on borrowed capital for year ended September 30, 1947	$ 13,361.68	
(b) Capital gain—year ended Sept. 30, 1945	10,321.38	
(c) Capital gain — year ended Sept. 30, 1947	3,300.00	26,983.06
Total		$1,263,886.87

Deductions:

(d) Net decrease in net income as shown under adjustments to net income above	$ 932,451.00	
[fol. 26] (e) Capital gain—year ended Sept. 30, 1945	10,321.38	
(f) Capital gain—year ended Sept. 30, 1947	3,300.00	
(g) Additional contributions on increased excess profits net income ($24,623.85 at 5%)	1,231.20	947,303.58
Excess profits net income adjusted		$ 316,583.29

Adjustment to Excess Profits Credit Based On Invested Capital

Invested capital as disclosed by return	$ 805,267.66
Deduction:	
(a) Accumulated earnings and profits	118,810.26
Invested capital as adjusted	$ 686,457.40

Explanation of Adjustment

(a) Accumulated earnings and profits at beginning of taxable year per return	$ 118,810.26
As corrected	none
Adjustment shown above	$ 118,810.26

Computation of Excess Profits Credit Based on Invested Capital

Invested capital as adjusted	$ 686,457.10
Excess profits credit (8% of $686,457.40	54,916.59

Excess Profits Tax Computation

Excess profits net income based on invested capital as shown above		$ 316,583.29
Less: Specific exemption	$ 10,000.00	
[fol. 27] Excess profits credit based on invested capital as shown above	54,916.59	
Unused excess profits credit from year ended Sept. 30, 1947 as shown below	14,529.80	79,446.39
Adjusted excess profits net income		$ 237,136.90
Surtax net income (before Sec. 26 (e) credit)		$ 293,190.63
80% of $293,190.63		$ 234,552.50
Income tax as shown above		20,318.49
Excess profits tax		$ 214,234.01
Less: 10% credit under Sec. 784		21,423.40
Excess profits tax liability		$ 192,810.61

Assessed:			
Original, Acc't #407101, May 1946 (3rd N. Y.)		$ 861,118.04	
Less: Credit allowed under Sec. 3806 (b)	$235,477.44		
Overassessment, Sch. #IT:CB:7136	612,042.13		
Overassessment. Sch. #IT:CB:7136 Suppl.	249,075.91		
		1,096,895.48	(235,477.44)
Deficiency of excess profits tax			$ 428,288.05

[fol. 28] Taxable Year Ended September 30, 1946

Adjustments to Net Income

Net income as disclosed by return		$(156,397.96)
Unallowable deductions and additional income:		
(a) Capital expenditures	$ 2,155.80	
(b) Entertaining expenses	1,198.83	
(c) Termination claims	20,206.20	
(d) Officer's salary	13,000.00	
(e) Contributions	131.25	36,692.08
Total		$(119,705.88)
Nontaxable income and additional deductions:		
(f) Depreciation	$ 4,359.30	
(g) New York State franchise tax	261.20	
(h) Renegotiation of war contracts	40,000.00	44,620.50
Net income for declared value excess profits tax computation, adjusted		$(164,326.38)

Explanation of Adjustments

(a) The amount of $2,155.80, representing capital expenditures included among the deductions in the return, is disallowed in accordance with the provisions of section 24(a) of the Internal Revenue Code.

(b) Entertaining expenses of $1,198.83 claimed among the deductions on the return are disallowed for lack of substantiation and failure to meet the other requirements of section 23(a) of the Internal Revenue Code.

[fol. 29] (c) The amount of $20,206.20, representing reimbursements received by you in the year ended September 30, 1947 by reason of the termination of government contracts, is held to constitute taxable income in this year, the year in which the value of your claims was determined, under the provisions of section 42 of the Internal Revenue Code since your returns are rendered on the accrual basis.

(d) It is held that a reasonable allowance for compensation for personal services rendered by Mrs. Madge Ferredy does not exceed $12,000.00 for the taxable year. The amount of $25,000.00 deducted in your return is accordingly disallowed to the extent of $13,000.00.

(e) Contributions of $131.25 deducted in your return are disallowed in accordance with the provisions of section 23(q) of the Internal Revenue Code since you sustained a net loss in this year.

(f) An additional depreciation deduction of $4,359.30 has been allowed.

(g) An additional deduction of $261.20 has been allowed for New York State franchise tax.

(h) To reduce net income per return by the amount of excessive profits arising from renegotiation of war contracts.

Adjustments to Excess Profits Net Income Computed Under Invested Capital Credit Method

Excess profits net income as disclosed by return		($147,201.91)
Deductions:		
(a) Net decrease in net income as shown under adjustments to net income above	$7,928.42	
[fol. 30] (b) 50% of interest on borrowed capital determined to amount to $8,076.26 in lieu of $9,196.05 reported	1,119.79	9,048.21
Excess profits net income adjusted		($156,250.12)

Adjustments to Excess Profits Credit Based on Invested Capital

Invested capital as disclosed by return		$873,424.24
Deductions:		
(a) Accumulated earnings and profits	$259,463.55	
(b) Average borrowed invested capital	30,174.52	289,638.07
Invested capital as adjusted		$583,786.17

Explanation of Adjustments

(a) Accumulated earnings and profits at beginning of taxable year per return	$259,463.55
As corrected	none
Adjustment shown above	$259,463.55
(b) Average borrowed invested capital per return	$301,460.69
As corrected	271,286.17
Adjustment shown above	$ 30,174.52

Computation of Excess Profits Credit Based on Invested Capital

Invested capital as adjusted	$ 583,786.17
Excess profits credit (8% of $583,786.17)	46,702.89

[fol. 31] Taxable Year Ended September 30, 1947

Adjustments to Net Income

Net income as disclosed by amended return		$(862,057.54)
Unallowable deduction and additional income:		
(a) Prepaid advertising	$52,152.66	
(b) Reserve for advertising	6,995.00	
(c) Capital expenditures	8,953.19	
(d) Entertaining expenses	4,639.43	
(e) Profit on sale of capital assets	3,300.00	76,040.28
Total		$(786,017.26)
Nontaxable income and additional deductions:		
(f) Depreciation	$	365.99
Net income adjusted		$(786,383.25)

Explanation of Adjustments

(a) The amount of $52,152.66, representing payments in advance for national advertising of vacuum cleaners in the subsequent year, which was included among the deductions claimed on the return, is disallowed on the ground that it does not constitute a proper deduction in this year under any of the provisions of the Internal Revenue Code.

(b) The amount of $6,995.00, representing an addition to a reserve for possible future advertising, which was included among the deductions on the return, is disallowed on the ground that it does not constitute a proper deduction in this year under any of the provisions of the Internal Revenue Code.

(c) The amount of $8,953.19, representing capital expenditures included among the deductions on the return, [fol. 32-36] is disallowed in accordance with the provisions of section 24(a) of the Internal Revenue Code.

(d) Entertaining expenses of $4,639.43 claimed among the deductions on the return are disallowed for lack of substantiation and failure to meet the other requirements of section 23(a) of the Internal Revenue Code.

(e) A profit of $3,300.00 realized by you on the sale of capital assets in the taxable year was erroneously omitted from income.

(f) An additional depreciation deduction of $365.99 has been allowed.

Computation of Excess Profits Credit Carry-Back
Based on Invested Capital

Amount paid in for capital stock	$250,000.00
25% of new capital	62,500.00
Average borrowed invested capital	408,066.99
Invested capital	$720,566.99
Excess profits credit (8% of $720,566.99)	$ 57,645.36
Excess profits credit carry-back (92/365 of $57,645.36)	$ 14,529.80

* * * * * * *

[fol. 37] The Tax Court of the United States

Lewyt Corporation, Petitioner,

v.

Commissioner of Internal Revenue, Respondent.

FINDINGS OF FACT AND OPINION—September 30, 1952

Held, the phrase "paid or accrued" as used in section 122(d)(6) of the Internal Revenue Code has reference to the system of accounting used by the taxpayer; *held further,* amounts tendered to the collector in 1947 by taxpayer as payment of additional excess profits taxes for 1943, 1944 and 1945 were not deductible in 1947.

FRED R. TANSILL, Esq., and EUGENE MEACHAM, Esq., for the petitioner.

ELLYNE E. STRICKLAND, Esq., for the respondent.

The taxpayer contests the following deficiencies determined by the Commissioner:

Taxable Year Ended	Tax	Amount
Sept. 30, 1944	Income	$ 7,129.21
Sept. 30, 1945	Excess Profits	428,288.05

The fiscal years ended September 30, 1946 and September 30, 1947 also are involved because of net operating losses sustained in those years which taxpayer contends were not properly computed before being carried back to [fol. 38] the taxable years. The Commissioner has asked an increased deficiency for the fiscal year ended September 30, 1945 based on what he now alleges was his improper allowance of a deduction of $55,949.04 claimed as interest on taxes paid during the fiscal year ended September 30, 1947. (References hereinafter to fiscal or taxable years are to the fiscal or taxable years of petitioner ending September 30 in the year or years mentioned.)

The following questions are presented for decision:

1. May excess profits taxes for 1945 which were paid in a stipulated amount within the fiscal year 1946 and excess profits taxes for 1943, 1944 and 1945 which were paid in

stipulated amounts within the fiscal year 1947, be added to the agreed net operating losses for the fiscal years 1946 and 1947 in computing the net operating loss carry-backs to the taxable years under the provisions of section 122(d)(6)?

2. Did certain amounts tendered by taxpayer to the collector of internal revenue on September 29, 1947 constitute payments of additional excess profits taxes for the fiscal years 1943, 1944, and 1945, within the fiscal year 1947?

3. Is taxpayer entitled to a deduction of $55,949.04 as interest paid or accrued during the fiscal year 1947?

4. May the amount of excess profits tax paid or accrued within the taxable year 1944 be used to reduce the net income for said year in computing the net operating loss carry-back from the fiscal year 1946 to the fiscal year 1945 under the provisions of section 122(b)(1)(A)(i)?

Findings of Fact

Some of the facts have been stipulated and are found accordingly.

Petitioner is a New York corporation, formed in 1942, engaged in the manufacture of vacuum cleaners and elec- [fol. 39] tronic devices. Its income and excess profits tax returns for the years involved were filed on the accrual method using a fiscal year ending each September 30, with the collector for the third district of New York.

For the fiscal years 1946 and 1947 petitioner incurred net operating losses of $164,326.38 and $786,383.25, respectively, not including any additions under section 122(d)(6).

During the fiscal year 1944 petitioner paid a total $759,-916.50 in excess profits tax which payments were made on petitioner's excess profits tax liability for the fiscal year 1943.

During the fiscal year 1945 petitioner paid a total of $510,939.23 on its excess profits tax liability for fiscal 1944.

Respondent determined petitioner's excess profits tax liability for fiscal 1944 to be $280,540.33 and its net income for the same year to be $420,540.43.

Petitioner's net operating losses for the fiscal years 1946 and 1947 in the respective amounts of $164,326.38 and $786,383.25 were allowable as carry-back deductions in the

fiscal years 1944 and 1945 and were so allowed by respondent.

Petitioner paid the excess profits tax liability shown on its return for the fiscal year 1945 during the fiscal year 1946 in the total amount of $861,118.04.

With reference to the fiscal year 1943 a dispute arose between petitioner and respondent. The major issue centered on whether the value of certain unfilled customers' orders and contracts which petitioner received by assignment from shareholders in two predecessor corporations were amortizable by petitioner and said amortization properly reflected as a deduction in cost of goods sold. Respondent by statutory notice dated August 30, 1946 asserted deficiencies against petitioner for the fiscal year 1943 of $7,757.49 in income tax and $194,992.51 in excess profits tax. These deficiencies were contested in a petition filed in this Court bearing docket No. 12526 on November 19, 1946. One of the errors assigned therein was the disallowance of the [fol. 40] above-described item. This question was placed in issue by respondent's answer filed December 23, 1946.

Petitioner's auditor was a certified public accountant experienced and qualified to act in tax matters. Both before and after the above proceeding was at issue attempts were made to settle the case. Conferences beginning about October 23, 1946 were held attended by the auditor and technical staff advisers. Petitioner's lawyers were present at some of the conferences. One such conference was held on September 26, 1947, and as a result the auditor believed that a basis for settlement had been arrived at for computing the additional tax due for the fiscal year 1943. On that basis the auditor recomputed the petitioner's tax liability and on September 29, 1947, petitioner addressed a letter to the collector transmitting petitioner's check payable to the collector for $190,002.16 and indicating it was for additional tax for fiscal 1943 in the amount of $154,473.30 and interest of $35,528.86. The letter bears a stamp showing receipt by a cashier in the collector's office for the third district of New York on September 29, 1947. The amount of this check was placed on September 29, 1947 in a suspense account maintained by the collector.

Subsequent conferences about the settlement of the

above case were held down to and including October 30, 1947. On November 6, 1947, the Head of the Technical Staff, New York Division, advised Division Counsel that settlement efforts on a satisfactory basis had proved ineffectual and defense of the case was recommended. On December 12, 1947, a written proposal of settlement was submitted by petitioner's attorney which the Technical Staff recommended on February 20, 1948, be accepted. A stipulation of settlement signed by the parties was filed with this Court on February 24, 1948. The stipulation showed that petitioner's excess profits tax liability for the taxable year 1943 was $140,147.87 and that petitioner had paid excess profits taxes on September 29, 1947 in the amount of $141,618.13, an overpayment of $1,470.26. This [fol. 41] Court entered its decision to that effect on March 3, 1948. The amount of $141,618.13 was part of the $190,-002.16 received by the collector on September 29, 1947 deposited in the above-mentioned suspense account.

Prior to September 30, 1947 and during that year a revenue agent was examining petitioner's returns for the years 1944, 1945, and 1946. This examination was expanded to include 1947. The amortization issue involved for the year 1943 was also present in 1944 and its disposition would affect the tax liability for 1945. Petitioner's auditor was in consultation with the agent and was advised of other proposed adjustments. The agent's report was dated July 26, 1948 and was forwarded to petitioner under date of August 25, 1948. Following the conference of September 26, 1947 referred to above, petitioner's auditor recomputed petitioner's tax liabilities for 1944 and 1945 on his understanding of the basis for settlement of the amortization question and giving effect to the other proposed adjustments mentioned to him by the agent.

On September 29, 1947, petitioner addressed a second letter to the collector transmitting petitioner's check payable to the collector in the amount of $178,810.92. The body of the letter stated:

Our check in the amount of One Hundred Seventy-Eight Thousand Eight Hundred and Ten Dollars and Ninety-Two Cents ($178,810.92) is computed as follows:—

Additional Tax—Year Ended September 30, 1944	$49,953.38	
Interest	8,492.07	
Total		$ 58,445.45
Additional Tax—Year Ended September 30th, 1945	$108,437.36	
Interest	11,928.11	
Total		$120,365.47
Grand Total		$178,810.92

This sum was received by the collector on September 29, 1947 and placed in the same suspense account with the $190,002.16.

[fol. 42] Petitioner charged the following amounts as taxes against earned surplus account in its books as of September 30, 1947:

For the Fiscal Year Ended Sept. 30, 1943	$154,473.30
For the Fiscal Year Ended Sept. 30, 1944	49,953.38
For the Fiscal Year Ended Sept. 30, 1945	108,437.36
Total	$312,864.04

The amount of $312,864.04 referred to in the preceding paragraph was reflected on the petitioner's Federal income tax return filed for the fiscal year ended September 30, 1947, as a charge against earned surplus.

Among the items petitioner charged as taxes against earned surplus account in its books as of September 30, 1947, there are three items totaling $312,864.04. The first of the three items is the amount of $154,473.30. This represents the additional tax liability of petitioner for the taxable year ended September 30, 1943, as recommended by its auditor and tendered by petitioner to the collector by check on September 29, 1947. Of this amount, $141,618.13 represented excess profits taxes and $12,855.17, income

taxes. The second item is the sum of $49,953.38, being the additional excess profits tax liability as recomputed by the auditor for the year ended September 30, 1944, and is the same amount shown in the letter transmitted to the collector of internal revenue on September 29, 1947, and tendered by check on the same day. Th third items is the additional excess profits tax liability as computed by the auditor for the taxable year ended September 30, 1945, and is in the sum of $108,437.36. This is the same amount referred to in the letter addressed to the collector of internal revenue dated September 29, 1947, and tendered by check dated the same day.

In one of the letters to the collector of internal revenue dated September 29, 1947, interest was computed and indicated in the sum of $35,528.86, and said amount of interest was included in the total amount of the check drawn pay-
[fol. 43] able to the collector of internal revenue in the total amount of $190,002.16.

In the second letter to the collector of internal revenue dated September 29, 1947, interest is indicated and computed in the amount of $8,492.07 on the additional tax for the year ended September 30, 1944, and in the amount of $11,928.11 on the additional tax for the year ended September 30, 1945. The check attached to said letter in the face amount of $178,810.92 drawn payable to the collector of internal revenue includes these two amounts.

Petitioner charged as an expense the following amounts as interest on taxes in its books for the fiscal year ended September 30, 1947:

For the Fiscal Year Ended Sept. 30, 1943	$35,528.86
For the Fiscal Year Ended Sept. 30, 1944	8,492.07
For the Fiscal Year Ended Sept. 30, 1945	11,928.11
Total	$55,949.04

The total of the three interest items referred to in the amount of $55,949.04 is the total of the amounts referred to in the two letters of September 29, 1947, and is the same amount deducted on the petitioner's books as of September 30, 1947.

The amount of $55,949.04 referred to in the preceding paragraph was claimed, together with other amounts, as

an interest deduction on the petitioner's Federal income tax return filed for the fiscal year ended September 30, 1947, which interest deduction was not adjusted or reduced by the respondent in his revenue agent's report.

Petitioner did not file any amended returns showing greater liability in income and excess profits taxes for the fiscal years ended September 30, 1944, and September 30, 1945, and no deficiency in tax for either of those years was asserted or determined by the Commissioner until after the close of the fiscal year ended September 30, 1947.

[fol. 44] OPINION

Tietjens, *Judge*: As we understand it, from opening statements of counsel and the briefs filed herein, the question upon which disposition of most of the issues herein depends is the construction of the words "paid or accrued within the taxable year" as they appear in section 122(d)(6) quoted in the footnote.[1] The "rules" referred to in that section are not material to the issue except as may be indicated hereafter. The taxes imposed by subchapter E of chapter 2 are "excess profits taxes" and that term will be used for convenience. The question is urged by taxpayer as one of first impression.

Taxpayer admittedly maintained its books and records and filed its tax returns using a fiscal year and computed its net income using the accrual method of accounting. Nevertheless, it contends that in applying section 122(d)(6) it is entitled to use, with reference to the year 1946, the amount actually paid in that year in satisfaction of its excess profits tax liability for the year 1945. A similar con-

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[1] SEC. 122. NET OPERATING LOSS DEDUCTION.

* * * * * * *

(d) Exceptions, Additions, and Limitations.—The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

* * * * * * *

(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

tention is made for the year 1947 during which certain

amounts were tendered to the collector as additional excess profits tax for the years 1943, 1944, and 1945. And for the year 1944, the argument is made that taxpayer is entitled not only to use, in making adjustments required under section 122(b)(1)(A)(i),[2] the amount of excess profits taxes [fol. 45] "paid" in 1944 on the liability for the previous year, but is also entitled to add to that amount at least $280,540.33 (its ultimate excess profits tax liability for 1944) which was "paid" in 1945.

In arriving at these conclusions taxpayer argues that the phrase "paid or accrued within the taxable year" refers "to the fact that an excess profits tax liability has arisen or that such a liability has been liquidated by payment" in the taxable year. On the other hand, the Commissioner refers to section 48(c)[3] and says that consonant therewith

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[2] SEC. 122. NET OPERATING LOSS DEDUCTION.

* * * * * * *

(b) Amount of Carry-Back and Carry-Over.—

(1) Net Operating Loss Carry-Back.—

(A) Loss for Taxable Year Beginning Before 1950.—If for any taxable year beginning after December 31, 1941, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed—

(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

* * * * * * *

[3] SEC. 48. DEFINITIONS.

When used in this chapter—

* * * * * * *

(c) "Paid or Incurred," "Paid or Accrued".—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

the phrase should be construed according to taxpayer's method of accounting.

The phrase is not defined either in section 122 itself or in the regulations issued thereunder. Neither do we think the legislative history of the section which is analyzed in the taxpayer's briefs and which we have diligently studied throws any light on the question.

It is noted that the Revenue Act of 1941 added a new subparagraph (2) to section 23(c) of the Code permitting a direct deduction for excess profits taxes paid or accrued within the taxable year. Thereafter, section 105 of the Revenue Act of 1942 withdrew this deduction and at the same time added the new provision — section 122(d)(6) which is in question here. A comparison of section 23(c) with section 122(d)(6) follows.

[fol. 46] Sec. 23, I. R. C.

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

• • •

(c) Taxes Generally.—

(1) Allowance in general.—Taxes paid or accrued within the taxable year, except—

• • •

(2) Excess-profits tax under chapter 2E—Special rules.—For the purposes of this subsection, in the case of the excess-profits tax imposed by Subchapter E of Chapter 2—

(A) The deduction shall be limited to the tax imposed for the taxable year, but any portion of such tax paid after the taxable year shall be considered as having been paid within the taxable year;

(B) No reduction in such tax shall be made by reason of the credit for income, war-

Sec. 122 (d), I. R. C.

"(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

. . . . . .

(A) No reduction in such tax shall be made by reason of the credit for income, war-profits,

Sec. 23, I. R. C.	Sec. 122 (d), I. R. C.
profits, or excess-profits taxes paid to any foreign country or possession of the United States;	or excess-profits taxes paid to any foreign country or possession of the United States;
(C) Such tax shall be computed without regard to the adjustments provided in section 734; and	(B) Such tax shall be comput'd without regard to the adjustments provided in section 734; and
(D) Such tax, in the case of a consolidated return under section 730, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary."	(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary."

[fol. 47] It will be seen that Rule (A) of section 23(c)(2) which had the effect of putting all taxpayers, regardless of cash or accrual basis on an accrual basis as far as the excess profits tax deduction was concerned, was omitted from the new section 122(d)(6). The taxpayer here infers from this that Congress must have intended not to place all taxpayers on an accrual basis. We do not clearly see how this inference helps the taxpayer, since it can be just as effectively argued as an inference that the ommission was intended to place each upon its method of accounting, though it may be true, as taxpayer says, that this might lead to inequitable results since accrual basis taxpayers would normally not be in position to accrue an excess profits tax liability in a loss year. However that may be, the omission is unexplained in the legislative history and we must take the section as we find it.[4]

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[4]This controversy has been anticipated by writers on tax problems. See J. K. Lasser, Excess Profits Tax Controversies, New York University Fourth Annual Institute on Federal Taxation, 806, 808, where he says with reference to section 122: "There is also some confusion as to the adjustment to be made for excess profits taxes 'paid or accrued within the taxable year.' This adjustment increases the net operating loss carryover. Some say that the adjustment is ordinarily available only to cash basis

To bolster its position that "paid or accrued" should be given a broader construction than merely referring to accounting systems, taxpayer cites *Commissioner* v. *Clarion Oil Co.*, 148 F. 2d 671, reversing 1 T. C. 751, which involved, among other issues, the interpretation of the terms "paid or accrued" as used in the Personal Holding Company provisions of the Internal Revenue Code. See sections 505 (a)(1) and 507(a). We think the rule there applied rests upon the peculiar nature of the problem of determing the *undistributed income* on which the penalty tax was levied [fol. 48] and should not be extended to the present controversy. In passing, we point out that only recently has this Court concluded to follow *Commissioner* v. *Clarion Oil Co., supra, Wm. J. Lemp Brewing Company*, 18 T. C. (No. 70.).

Despite taxpayer's belief that the present case is one of first impression, the Commissioner cites and relies on *Estate of Julius I. Byrne*, 16 T C. 1234. One of the issues in that case was petitioner's claim under section 122 that its net operating loss carry-back from 1945 should be increased by the amount of its excess profits taxes for 1944 which were paid in 1945. This claim was based on petitioner's allegation that its returns were filed on the cash basis. We held that petitioner had failed to prove it was on

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taxpayers, since no excess profits taxes would accrue in the year of the net operating loss except in very rare cases. But others argue strenuously that this would be an undue discrimination against accrual basis taxpayers, and that the words 'paid or accrued' permit accrual basis companies to make the adjustment for taxes accrued during the prior year but paid during the year of the net operating loss. This could produce very odd results in some cases, and the question will have to await further clarification."

Also see footnote to Jacquin D. Bierman, Excess Profits Net Income for the Current Taxable Year, New York University Tenth Annual Institute on Federal Taxation, 231, at page 245: "It might be noted, in passing, that *cash basis* taxpayers can no longer add to the net operating loss the excess profits tax paid during the year of the loss. See Section 304(e) of Excess Profits Tax Act of 1950 repealing Section 122(d)(6) for years ending after June 30, 1950." [Emphasis supplied.]

the cash basis, and "as a consequence, it has failed to show that it is entitled to deduct the excess profits taxes for 1944 in computing the 1945 carry-back. It did not owe any excess profits taxes for 1945 and did not accrue any." In other words, an accrual basis taxpayer cannot increase its net operating loss carry-back for a particular year by adding in the amount of excess profits taxes paid in that year on its liability for the previous year. This case seems to us squarely to confirm the Commissioner's contentions here, and we hold that in making the computations called for under section 122(d)(6) the phrase "paid or accrued" should be construed according to the method of accounting upon the basis of which taxpayer's net income is computed.

This would dispose of the case were it not for taxpayer's alternate contention with reference to the amounts tendered to the collector in 1947. As to these amounts taxpayer argues, that, accepting the interpretation we have put on the controversial phrase, nevertheless, the amounts paid to the collector in 1947 were properly accrued in that year notwithstanding they represented additional excess profits taxes for prior years. The argument goes that the additional taxes were in dispute—those for 1943 by virtue of the petition filed with this Court—those for 1944 because their amount depended upon a recurring issue present in [fol. 49] the Tax Court case, and those for 1945 because excess profits credits and franchise taxes for that year were not knowable until the disputes for the prior years had been resolved. Further, that the amounts received by the collector on September 29, 1947 constituted tax payments which an accrual basis taxpayer was required to deduct not later than the date of payment.

We think the Commissioner must be sustained on this point, even though taxpayer's liability for 1943 was contested by the filing of a petition in this Court. True, that effectively postponed its right to accrue the contested liability under the principles enunciated in *Dixie Pine Products Co.* v. *Commissioner*, 320 U. S. 516. And it is established that when an accrual basis taxpayer pays all or part of the contested liability, that taxpayer is required to deduct the amounts paid in the year of payment. *Chestnut Securities Co.* v. *United States*, (Ct. Cls.) 62 F. Supp. 574; *Lehigh Valley Railroad Co.*, 12 T. C. 977.

The troublesome point is whether the amounts tendered to the collector on September 29, 1947 representing estimated additional taxes for 1943, 1944, and 1945 constituted "tax payments" or "taxes paid" in 1947 and were thus properly deductible in 1947. We are of the opinion the answer should be "no".

As far as the amount for 1943 is concerned the taxpayer concluded that an acceptable formula for settling its Tax Court case had been found. But the amount determined pursuant to the formula was turned over to the collector in 1947 and deposited by him in a "suspense account". The Tax Court case was not by this means settled or determined. Further conferences were held respecting the pending settlement after the formula was arrived at, and as late as November 6, 1947 the Technical Staff was recommending defense of the case to the Division Counsel. Both the taxpayer and the Commissioner were still free to pursue the contest of the 1943 liability and neither was foreclosed on that score at least till the stipulation disposing of the case was signed on February 24, 1948 after the [fol. 50] Technical Staff had recommended that this be done on February 20, 1948. Under the facts of this case petitioner is not entitled to deduct the amount tendered for 1943 taxes in 1947.

Nor does the record before us furnish any basis for allowing taxpayer to deduct in 1947 the amounts tendered to the collector purportedly representing additional excess profits taxes for 1944 and 1945. The taxpayer filed no amended returns showing greater liability in income and excess profits taxes for 1944 and 1945 and no deficiencies in tax for either of those years were asserted or determined by the Commissioner until after the close of fiscal 1947. The most that can be said is that an audit was under way involving those years. True, it probably appeared to the taxpayer that there would be additional taxes due, but nothing definitive had developed. The revenue agent's report covering 1944 and 1945 was not forwarded to taxpayer until August 25, 1948. In these circumstances the taxpayer cannot take deduction for these amounts in 1947. See *Rosenman* v. *United States*, 323 U. S. 658; *Roles* v. *Earle*, (C. A. 9, 1952), F. 2d , which indicate

that none of the amounts tendered in 1947 and placed in the suspense account in that year constitute "taxes paid". We accordingly hold that the amounts paid over by taxpayer to the collector in 1947 cannot be deducted in that year.

The parties are agreed that our decision as to the principal amounts involved will govern the treatment to be accorded the interest payment made and consequently no discussion of that question will be necessary.

With reference to issue 4 set out in the preliminary statement hereto, petitioner states on brief that it, as well as issues 1 and 2, turns "upon the meaning to be placed on the same identical phrase", i.e., "paid or accrued". The Commissioner in his brief has addressed no argument specifically to this issue and we take it that the interpretation which we have above given to the critical phrase will also dispose of this question.

Reviewed by the Court.

Decision will be entered under Rule 50.

[fols. 51-107] BEFORE THE TAX COURT OF THE UNITED STATES

Washington

[Title omitted]

DECISION—April 9, 1953

Pursuant to the determination of this Court, as set forth in its Findings of Fact and Opinion promulgated September 30, 1952, the respondent and the petitioner each duly filed a proposed computation of tax in accordance therewith. After hearing thereon and careful consideration of the arguments made in the written briefs filed by the parties, the respondent's computation is approved, and it is therefore

ORDERED AND DECIDED: That there is a deficiency in income tax of $7,129.21 for the taxable year ended Sep-

tember 30, 1944; and that there is a deficiency in excess profits tax of $466,557.19 for the taxable year ended September 30, 1945.

Enter:

(Signed.) Norman O. Tietjens, Judge.

Entered Apr 9, 1953.

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* * * * * * *

[fol. 108] BEFORE THE TAX COURT OF THE UNITED STATES

[Title omitted]

STIPULATION OF FACTS—Filed October 30, 1951

Come now the above-named parties to this proceeding, and through their respective counsel of record stipulate and agree that the following facts are to be admitted into evidence as true, subject, however, to the right of either party to introduce further evidence not inconsistent with anything stipulated herein:

1. Petitioner is a New York Corporation with its principal office at 60 Broadway, Brooklyn 11, New York. It was formed on December 30, 1942.

2. Petitioner is and was a manufacturer of vacuum cleaners and electronic devices.

3. Respondent has determined deficiencies as follows:

Year Ended	Type of Tax	Amount
September 30, 1944	Income	$ 7,129.21
September 30, 1945	Excess Profits	428,288.05

Also involved in this proceeding are the fiscal years ended September 30, 1946, and September 30, 1947, in each of which fiscal years net operating losses were sustained by the petitioner which affect the taxable years.

[fols. 109-110] Petitioner filed its income tax returns and excess profits tax returns for the taxable years here involved and for the years ended September 30, 1946, and September 30, 1947, with the Collector for the Third Dis-

trict of New York. Petitioner maintained its books and records and filed its tax returns on the accrual method of accounting, using a fiscal year ending each September 30th.

5. For the fiscal year ended September 30, 1946, petitioner incurred a net operating loss, in the amount of $164,326.38, which amount does not include any additions under Section 122 (d) (6) of the Internal Revenue Code.

6. For the fiscal year ended September 30, 1947, petitioner incurred a net operating loss in the amount of $786,383.25, which amount does not include any additions under Section 122 (d) (6) of the Internal Revenue Code.

7. Petitioner paid a total of $759,916.50 in excess profits tax during the taxable year ended September 30, 1944, which payments were made on petitioner's excess profits tax liability for the fiscal year ended September 30, 1943, as shown on its excess profits tax return for said fiscal year.

8. Petitioner paid a total of at least $453,049.29 on its excess profits tax liability for the year ended September 30, 1944, which amount was paid during the taxable year ended September 30, 1945.

9. Petitioner paid the excess profits tax liability shown on its federal excess profits tax return for the fiscal year ended September 30, 1945, during the fiscal year ended September 30, 1946, in the total amount of $861,118.04.

* * * * * * *

[fols. 111-136] Fred R. Tansill, Counsel for Petitioner. (Signed) Charles Oliphant, R. P. H., Counsel for Respondent.

[fols. 137-187] Before the Tax Court of the United States

[Title omitted]

Supplemental Stipulation of Facts—Lodged December 18, 1951

Come now the above-named parties to this proceeding, and through their respective counsel of record stipulate and agree that the following facts are to be admitted in evidence as true, as paragraph 8 of the Stipulation of Facts, in lieu

of paragraph 8 as it originally appeared in the Stipulation of Facts:

8. Petitioner paid a total of $510,939.23 on its excess profits tax liability for the year ended September 30, 1944, which amount was paid during the taxable year ended September 30, 1945.

(S.) Fred R. Tansill, Counsel for Petitioner, 824 Connecticut Avenue, N. W., Washington 6, D. C. (Sgd.) Mason B. Leming, R. P. H., Counsel for Respondent.

[fols. 188-189] Before the Tax Court of the United States

PETITIONER'S EXHIBIT 19, ADMITTED IN EVIDENCE

United States Corporation Excess Profits Tax Return for Fiscal Year Ending September 30, 1944.

(Here follows 2 Photolithographs, side folios 189, 189a)

[213]

Computation Proved

Form 1121
Treasury Department
Internal Revenue Service

UNITED STATES
CORPORATION EXCESS PROFITS TAX RETURN
For Calendar Year 1943

or fiscal year beginning Oct. 1, 1943, and ending Sept. 30, 1944

1943

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

LEVITT CORPORATION
(Name)

431 East 52nd Street
(Street and number)

New York 22 (City or Town) N. Y. (State)

Business group serial number entered on page 1, Form 1120 57

Fed. Ex. Code 8 5-2
Serial No. 2 407342
District

1945 FEB

Cash Check M. O.
Tax Stamps

3405.12

POST-WAR CREDIT AND REFUND BRANCH C:CC-2

THE TAX COURT OF THE U.S.
DOCKET 2-8151
ADMITTED IN EVIDENCE
OCT 30 1951
PETITIONER'S
EXHIBIT 19
RESPONDENT'S

REPORTED
FEB 15 1945

EXCESS PROFITS TAX COMPUTATION

		Column 1 Income Credit Method	Column 2 Invested Capital Credit Method
1.	Excess profits net income (line 16, Schedule A)	$	$ 827,852.99
2.	Specific exemption	$ 5,000	$ 5,000
3.	Excess profits credit—based on income (line 46, Schedule B)	x x x x x x x x	x x x x x x x x
4.	Excess profits credit—based on invested capital (line 41, Schedule C)	x x x x x x x x	76,629.91
5.	Unused excess profits credit adjustment (attach schedule)		
6.	Total of items 2 to 5		$ 81,629.91
7.	Difference between item 1 and item 6		$ 746,223.08
8.	Adjusted excess profits net income (item 7, column 1 or item 7, column 2, whichever is applicable)		$ 746,223.08
9.	90 percent of item 8		$ 671,600.77
10.	Net income (computed without regard to the specific exemption provided by section 26 (e)) (item 35, page 2, Form 1120)		$ 817,680.90
11.	Less: (a) Dividends received credit (85 percent of amount in column 2, Schedule E, Form 1120) (excluding dividends received on certain preferred stock of public utility), but not in excess of 85 percent of item 10 above)		
	(b) Dividends paid on certain preferred stock of public utility (line 20, page 2, Form 1120)		
12.	Surtax net income (computed without regard to the credit provided by section 26 (b))		$ 817,680.90
13.	80 percent of item 12		654,144.72
14.	Income tax under Chapter 1 (other than tax computed under section 102) for taxable year (item 41, page 1, Form 1120)		28,583.13
15.	Excess of item 13 over item 14		$ 625,561.59
16.	Item 9, or item 15, whichever is lesser		$ 625,561.59
17.	Amount deferred by reason of the application of section 710 (a) (1) (B) (relief from abnormality under section 722) (attach schedule)		$
18.	Excess profits tax:		
	(a) Item 16 minus item 17	$ 625,561.59	
	(b) If schedule is filed under question (g), page 2, amount of tax at corresponding schedule		
	(c) Item 18 (a) or item 18 (b), whichever is applicable		$ 625,561.59
19.	Less: Credit for income taxes paid to a foreign country or United States possession allowed to a domestic corporation (portion not used in computing item 42, page 1, Form 1120)		
20.	Item 18 (c) minus item 19		$ 625,561.59
21.	Less: Credit for debt retirement (item 28, below)		20,000.00
22.	Item 20 minus item 21		$ 605,561.59
23.	Amount, if any, due to application of section 734 (adjustment in case of position inconsistent with prior income tax liability) (attach schedule)		
24.	Excess profits tax due (item 22 plus item 23, or item 22 minus item 23, whichever is applicable)		$ 605,561.59

POST-WAR REFUND OF EXCESS PROFITS TAX AND CREDIT FOR DEBT RETIREMENT

25.	Balance of excess profits tax (item 18 (c), above)		$ 625,561.59
26.	Credit allowable under sections 780 and 781 (10 percent of item 25) (but in cases where item 19 is applicable, see Specific Instructions 26-27)		$ 62,556.16
27.	Lesser of amounts paid on indebtedness or net reduction in indebtedness under section 783 (b) (2)	$ 50,000.00	
28.	Credit for debt retirement allowable under section 783 (40 percent of item 27, but not in excess of 10 percent of item 25)		20,000.00
29.	Net post-war refund credit (item 26 minus item 28) Subject to Reconciliation attached		$ 42,556.16

We, the undersigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return (including any accompanying schedules and statements) has been examined by him and is, to the best of his knowledge and belief, a true, correct, and complete return, made in good faith for the taxable year stated, pursuant to the Internal Revenue Code and the regulations issued thereunder.

Subscribed and sworn to before me this 12th day of February, 1945

NOTARIAL SEAL — HENRIETTA B. ROSENBERG, NOTARY PUBLIC, Kings Co. Clk's No. 470, Reg. No. [illegible], N. Y. Co. Clk's No. 470, Reg. No. [illegible], Commission Expires March 30, 1945 — (Title)

(President or other principal officer) (State this)

CORPORATE SEAL

(Treasurer, Assistant Treasurer, or Chief Accounting Officer) (State this)

I/we swear (or affirm) that I/we prepared this return for the above named person and that the statements contained herein and that the return (including any accompanying schedules and statements) is a true, correct, and complete statement of the excess profits tax liability of the person for whom this return has been prepared of which I/we have any knowledge.

Subscribed and sworn to before me this 12th day of February, 1945

NOTARIAL SEAL — HENRIETTA B. ROSENBERG, NOTARY PUBLIC, Kings Co. Clk's No. 470, Reg. No. [illegible], N. Y. Co. Clk's No. [illegible], Commission Expires March 30, 1945 — (Title)

Walter Leidman
(Signature of person preparing the return)

(Signature of person preparing the return)

Allison I. Brown
(Address) (Name of firm or employer, if any)

QUESTIONS

(a) Date of incorporation December, 1942 (b) State or country New York

(c) Collector's office in which your income tax return for the taxable year was filed 3rd. New York

(d) Is this a consolidated return? No If so, procure from the collector Form 851, Affiliations Schedule, which shall be filled in, sworn to, and filed as a part of the consolidated income tax return.

(e) In computing the excess profits credit under the invested capital method, do you elect to include in excess profits net income interest received on, reduced by the amount of amortizable bond premium under section 125 attributable to, all Government obligations described in section 22(b)(4) of the Internal Revenue Code? (Answer "yes" or "no") Yes

(f) Are you a transferor or transferee upon an exchange as defined by section 760 or 761 of the Internal Revenue Code? (Answer "yes" or "no") No

(g) Does this return involve an adjustment of the excess profits tax liability due to the application of the sections specified in (1) below? (Answer "yes" or "no") No If answer is "yes":

(1) Check the appropriate sections and submit schedules showing computation: 710(a)(4) ☐; 721 ☐; 726 ☐; 731 ☐; 735(b) ☐; 735(c) ☐; 736(a) ☐; 736(b) ☐. (See General Instructions E, F, G, H, and I.) (Enter amount of excess profits tax as Item 18 (b), page 1.)

(2) From the schedules submitted under (1) above, enter any tax adjustment which results from the application of each of the following sections: 721, $ .....; 726, $.....; 731, $.....

(3) From the schedules submitted under (1) above, enter any income adjustment which results from the application of each of the following sections: 721, $.....; 731, $.....; 735(b), $.....; 735(c), $.....

(h) State amount of total assets as of the end of the taxable year. (From Form 1120, page 4, line 8, last column), $.....

Schedule A.—EXCESS PROFITS NET INCOME COMPUTATION

Line No.		Column 1 Income Credit Method		Column 2 Invested Capital Credit Method
1.	Normal-tax net income (computed without allowance of credit for income subject to excess profits tax and without allowance of dividends received credit) (item 27, page 1, Form 1120)	$		$ 817,680.90
2.	Net short-term capital gain (do not enter net short-term capital loss)			
3.	Adjustment to net operating loss deduction			
4.	Decrease in deductions limited by income			
5.	50 percent of interest on borrowed capital	x x x x x x x	x x	10,172.00
6.	Interest on Government obligations (see question (e) above, for election)	x x x x x x x	x x	
7.	Total of lines 1 to 6	$		$ 827,852.90
8.	Net gain from sale or exchange of capital assets (item 12 (a), page 1, Form 1120)	$		$

or "no") ..... If answer is "yes":

(1) Check the appropriate sections and submit schedules showing computation: 710(a)(4) ☐; 721 ☐; 726 ☐; 731 ☐; 735(b) ☐; 735(c) ☐; 736(a) ☐; 736(b) ☐. (See General Instructions E, F, G, H, and I.) (Enter amount of excess profits tax as Item 18 (b), page 1.)

(2) From the schedules submitted under (1) above, enter any tax adjustment which results from the application of each of the following sections: 721, $ .....; 726, $.....; 731, $.....

(3) From the schedules submitted under (1) above, enter any income adjustment which results from the application of each of the following sections: 721, $.....; 731, $.....; 735(b), $.....; 735(c), $.....

(h) State amount of total assets as of the end of the taxable year. (From Form 1120, page 4, line 8, last column), $.....

Schedule A.—EXCESS PROFITS NET INCOME COMPUTATION

Line No.		Column 1 Income Credit Method		Column 2 Invested Capital Credit Method
1.	Normal-tax net income (computed without allowance of credit for income subject to excess profits tax and without allowance of dividends received credit) (item 27, page 1, Form 1120)	$		$ 817,680.90
2.	Net short-term capital gain (do not enter net short-term capital loss)			
3.	Adjustment to net operating loss deduction			
4.	Decrease in deductions limited by income			
5.	50 percent of interest on borrowed capital	x x x x x x x	x x	10,172.00
6.	Interest on Government obligations (see question (e) above, for election)	x x x x x x x	x x	
7.	Total of lines 1 to 6	$		$ 827,852.90
8.	Net gain from sale or exchange of capital assets (item 12 (a), page 1, Form 1120)	$		$
9.	Income from retirement or discharge of bonds, etc.			
10.	Refunds and interest on Agricultural Adjustment Act taxes			
11.	Recoveries of bad debts			
12.	Increase in deductions limited by income			
13.	(a) Dividends received credit adjustment (item 13, page 1, Form 1120, excluding dividends received from foreign corporations)			x x x x x x x x x
	(b) Dividends received credit adjustment (item 13, page 1, Form 1120, excluding dividends received from foreign personal holding companies and dividends received on stock held primarily for sale to customers by a dealer in securities)	x x x x x x x	x x	
14.	Nontaxable income of certain industries with depletable resources			
15.	Total of lines 8 to 14	$		$ 827,852.90
16.	Excess profits tax net income computed without regard to deductions applicable to life insurance companies (line 7 minus line 15)	$		$
17.	Deductions applicable to life insurance companies			
18.	Excess profits net income computed under income credit method or invested capital credit method (line 16, or line 16 minus line 17 in case of a life insurance company)	$		$ 827,852.90

[fol. 190] Lewyt Corporation

431 East 52nd Street, New York 22, N. Y.

Form 1121—Page 4—Line 29—Average Borrowed Capital

	Days		
Oct. 1, 1943 to June 30, 1944	274	$621,750.42	$170,359,615.08
July 1, 1944 to Sept. 11, 1944	73	821,750.42	59,987,780.66
Sept. 12, 1944 to Sept. 29, 1944	18	921,750.42	16,591,507.56
Sept. 30, 1944	1	871,750.42	871,750.42
Totals	366		$247,810,653.72
Average Borrowed Capital			$ 677,078.29

Lewyt Corporation

431 East 52nd Street, New York 22, N. Y.

Fiscal Year Ended Sept. 30, 1944

Tentative Tax Computed Under Revenue Act of 1943

Excess Profits Taxes

Excess Profits Net Income		$827,852.99
Less—Excess Profits Credit	$ 76,629.91	
Specific Exemption	10,000.00	86,629.91
Adjusted Excess Profits Net Income		$741,223.08
95%		$704,161.93
Net Income before deducting Income subject to Excess Profits Tax		$817,680.90
80%		654,144.72
Less Normal & Surtax		30,583.13
Excess Profits Tax—Tentative		$623,561.59

Normal Tax & Surtax

Net Income	$817,680.90	
Less Income subject to Excess Profits Tax	741,223.08	
Normal Tax & Surtax Net Income		$ 76,457.82
Normal Tax 24%	$ 18,349.88	
Surtax 16%	12,233.25	
Toral Normal Tax & Surtax—Tentative		$ 30,583.13

[fol. 191]

Recapitulation

Normal Tax & Surtax			
92/365 of Tentative Tax under Revenue Act of 1942	$ 28,583.13	$ 7,204.51	
273/365 of Tentative Tax under Revenue Act of 1943	30,583.13	22,874.50	
Total Normal Tax & Surtax			$ 30,079.01
Excess Profits Tax			
92/365 of Tentative Tax under Revenue Act of 1942	$625,561.59	$157,675.80	
273/365 of Tentative Tax under Revenue Act of 1943	623,561.59	466,389.91	
Total Excess Profits Tax			$624,065.71
Less Credit for Debt Retirement (40% of $50,000.00)			20,000.00
Net Excess Profits Tax			$604,065.71
Post War Refund			
10% of Excess Profits Tax of $624,065.71	$ 62,406.57		
Less Credit for Debt Retirement	20,000.00		
Post War Refund		$ 42,406.57	

[fol. 192] Office of the Collector
Third District of New York
110 East 45th Street—Room 418
In reply refer to IT:GHS

Treasury Department
Internal Revenue Service
New York, N. Y. 17

December 14, 1944
This Extention Does Not Extend
The Time for Filing Form 1120

Lewyt Corporation
c/o Alson & Brown
285 Madison Ave. NYC

Gentlemen:

Receipt is acknowledged of your application of recent date requesting an extension of time to file your Corporaton Excess Profits Tax Return, Form 1121, coverng the year ended 9/30/44.

An extension of time within which to file your Form 1121 is hereby granted you under the following conditions:

That You File a Tentative Return On Or Before Dec. 26, 1944 and Your Completed Return On Or Before Feb. 15, 1945.

Tentative Return is not required if there will be no tax due on completed return.

A payment of at least one-fourth of the estimated tax shall be made with the Tentative Return. Any deficiency in the first installment of tax will bear interest at the rate of one-half of one per cent a month from the original due date.

By a Tentative Return is meant a return on the appropriate income tax form showing only the name and address of the taxpayer and the estimated amount, if any, of tax due. Items and schedules shown on the form need not be [fol. 193] filled in. However, the enclosed statement must be attached to the tentative return.

This letter must be attached to the Tentative Return and the copy to the Completed Return as authority for the extension of time herein granted.

It is imperative that both the Tentative and Completed Returns be filed with the Collector of Internal Revenue, Third District of New York, 110 East 45th Street, New York, New York (17).

Very truly yours,

JOSEPH D. NUNAN, JR.,
Commissioner of Internal Revenue.
By: JAMES W. JOHNSON,
Collector of Internal Revenue.

Lewyt Corporation

Year Ended September 30, 1944

Income Tax Computation Corrected

	1943 Rates	1944 Rates	Aggregate
Net income per return	747,236.60	747,236.60	
Less: Income subject to excess profits tax	675,778.78	670,778.78	
Normal & surtax net income	71,457.82	76,457.82	
Normal tax at 24%	17,149.88	18,349.88	
Surtax at 16%	11,433.25	12,233.25	
Tentative income tax	28,583.13	30,583.13	
Tax at 1943 rates 92/366 of 28,583.13	7,184.83		
Tax at 1944 rates 274/366 of 30,583.13		22,895.57	
Total income tax			30,080.40

[fol. 194]

Excess Profits Tax Computation Corrected

Net income	747,236.60	747,236.60	
Add: 50% of Int. on borrowed capital	10,172.09	10,172.09	
Excess profits net income	757,408.69	757,408.69	
Less: Specific exemption	5,000.00	10,000.00	
Excess profits credit	76,629.91	76,629.91	
8. Adjusted excess profits net income	675,778.78	670,778.78	
9. 90 & 95% of item 8	608,200.90	637,239.84	
12. Surtax net income	747,236.60	747,236.60	
13. 80% of item 12	597,789.28	597,789.28	
14. Tentative income tax under Chapter 1	28,583.13	30,583.13	
15. Excess of item 13 over item 14	569,206.15	567,206.15	
Tentative excess profits tax (lesser of item 9 or item 15)	569,206.15	567,206.15	
Tax at 1943 rates 92/366 of 569,206.15	143,079.14		
Tax at 1944 rates 274/366 of 567, 206.15		424,629.74	
Total excess profits tax			567,708.88
Less: Credit for debt retirement			20,000.00
Excess profits tax due			547,708.88

Computation of Credit Under Section 3806(b)

Net income per amended return	747,236.60
Less: Excessive profits on renegotiation	397,970.00
Net income after renegotiation	349,266.60
Less: 10% of ($15,000,000.00) D. V. Capital Stock	1,500,000.00
Balance subject to D. V. E. P. tax	None

[fol. 195]

Income Tax Computation

Net income revised	349,266.60	349,266.60	
Less: Income subject to excess profits tax	277,808.78	272,808.78	
Normal and surtax net income	71,457.82	76,457.82	
Normal tax at 24%	17,149.88	18,349.88	
Surtax at 16%	11,433.25	12,233.25	
Tentative income tax	28,583.13	30,583.13	
Tax at 1943 rates 92/366 of $28,583.13	7,184.83		
Tax at 1944 rates 274/366 of $30,583.13		22,895.57	
Total income tax			30,080.40

Excess Profits Tax Computation

	1943 Rates	1944 Rates	Aggregate
Net income revised	349,266.60	349,266.60	
Add: 50% of Interest on borrowed capital	10,172.09	10,172.09	
Excess Profits net income	359,438.69	359,438.69	
Less: Specific exemption	5,000.00	10,000.00	
Excess profits credit	76,629.91	76,629.91	
8. Adjusted excess profits net income	277,808.78	272,808.78	
9. 90 & 95% of item 8	250,027.90	259,168.34	
12. Surtax net income before credits	349,266.60	349,266.60	
13. 80% of item 12	279,413.28	279,413.28	
14. Tentative income tax under Chapter 1	28,583.13	30,583.13	
15. Excess of item 13 over item 14	250,830.15	248,830.15	
Tentative excess profits tax (lesser of item 9 or item 15)	250,027.90	248,830.15	
Tax at 1943 rates 92/366 of $250,027.90	62,848.54		
Tax at 1944 rates 274/366 of $248,830.15		186,282.67	
Total excess profits tax			249,131.21
Less: Credit for retirement (40% of $50,000.00)			20,000.00
Excess profits tax due			229,131.21

[fol. 196]

Comparison of Tax Computations

		Return Corrected	Revised	Difference = Tax on Excessive Profits of $397,970.00
Income tax	(Ch. 1)	30,080.40	30,080.40	—
D. V. E. P. tax	(Ch. 2B)	None	None	
Excess profitx tax	(Ch. 2E)	547,708.88	229,131.21	318,577.67
Totals		577,789.28	259,211.61	318,577.67

Post-War Refund of Excess Profit Tax

Excess profits tax	249,131.21
Credit allowance, 10%	24,913.12
Less: Credit for debt retirement (40% of $50,000.00)	20,000.00
Net post-war refund credit	4,913.12

[fol. 197]

Computation of Credit Under Section 3806(b)

Net income per amended return	747,236.60
Less: Excessive profits on renegotiation	397,970.00
Net income after renegotiation	349,266.60
Less: 10% of ($15,000,000.00) D. V. Capital stock	1,500,000.00
Balance subject to D. V. E. P. tax	None

Normal & Surtax Computation

No adjustment made

Excess Profits Tax Computation

	1943	1944
Excessive profits on renegotiation	397,970.00	397,970.00
Excess profits tax at 90% & 95%	358,173.00	378,071.50
Apportionment		
92/366 of $358,173.00	90,032.56	
274/366 of 378,071.50		283,037.13
Total excess profits tax on excessive profits of 397,970.00		373,069.69

[fols. 198-199] Schedule B—Excess Profits Credit—Based on Income.

(Here follows 1 Photolithograph, side folio 198-199)

Schedule B.—EXCESS PROFITS CREDIT—BASED ON INCOME

TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1939, AND BEFORE JANUARY 1, 1940
(If additional columns are required, attach separate schedule)

Line No.		1. Year Ended ____, 19__	2. Year Ended ____, 19__	3. Year Ended ____, 19__	4. Year Ended ____, 19__
1.	Normal-tax (or special-class) net income	$	$	$	$
2.	Net capital loss used in computing line 1				
3.	Securities which are capital assets deducted in computing line 1 as bad debts or as stock determined to be worthless (for taxable years beginning prior to January 1, 1938)				
4.	Net loss from sale or exchange of property other than capital assets deducted in computing line 1 (for taxable years beginning after December 31, 1937)				
5.	Net loss from involuntary conversion of property deducted in computing line 1				
6.	Total of lines 1 to 5	$	$	$	$
7.	Net capital gain used in computing line 1	$	$	$	$
8.	Net gain from sale or exchange of property other than capital assets used in computing line 1 (for taxable years beginning after December 31, 1937)				
9.	Net gain from involuntary conversion of property used in computing line 1				
10.	Total of lines 7 to 9	$	$	$	$
11.	Difference between lines 6 and 10	$	$	$	$
12.	Net gain from sale or exchange of capital assets after considering net capital loss carry-over				
13.	Net gain from sale, exchange, or involuntary conversion of property other than capital assets				
14.	Total of lines 11 to 13	$	$	$	$
15.	Net loss from sale, exchange, or involuntary conversion of property other than capital assets	$	$	$	$
16.	Stock and securities of affiliated corporations which became worthless during the taxable year (if included in line 2, 3, or 7)				
17.	Total of lines 15 and 16	$	$	$	$
18.	Normal-tax (or special-class) net income after applying section 711 (b) (2) (line 14 minus line 17)	$	$	$	$
19.	Net short-term capital gain after considering net capital loss carry-over (do not enter net short-term capital loss)				
20.	Dividends received credit				
21.	Deductions on account of retirement or discharge of bonds, etc.				
22.	Casualty, demolition, and similar losses not taken into account in computing line 12, 13, or 15				
23.	Repayment of processing tax to vendee				
24.	(a) Abnormal judgment liabilities, etc. (attach statement)				
	(b) Abnormal expenditures for intangible drilling and development costs (attach statement)				
	(c) Other abnormal deductions (attach statement)				
25.	Capitalization of expenditures for advertising or promotion of goodwill (attach statement)				
26.	Total of lines 18 to 25	$	$	$	$
27.	Income from retirement or discharge of bonds, etc.	$	$	$	$
28.	Dividends received from domestic corporations				
29.	Net gain from sale or exchange of capital assets after considering net capital loss carry-over (line 12, above)				
30.	Total of lines 27 to 29	$	$	$	$
31.	Excess profits net income (line 26 minus line 30)	$	$	$	$
32.	Net aggregate of columns 1, 2, 3, and 4				$
33.	Increase in lowest year in base period (attach statement)				
34.	Total of lines 32 and 33				$
35.	Average base period net income—General average (line 34 divided by number of months in base period, multiplied by 12)				$

(Fill in lines 36 to 42 for computation of average base period net income where there are increased earnings in last half of base period)

36.	Net aggregate of columns 3 and 4, line 31 (see instruction regarding limitation applicable to taxable year ending after May 31, 1940)	$
37.	Net aggregate of columns 1 and 2, line 31	
38.	Excess of line 36 over line 37	$
39.	One-half of line 38	
40.	Line 36 plus line 39	$
41.	Line 40 divided by number of months in second half of base period, multiplied by 12	$
42.	Average base period net income—Increased earnings in last half of base period (line 41, or the highest excess profits net income for any taxable year in the base period, whichever is lesser)	$
43.	95 percent of line 35 or line 42, whichever is greater	$
44.	Net capital addition, $_____; or net capital deduction, $_____ (attach statement).	
45.	8 percent of line 44, if a net capital addition (or 6 percent of line 44, if a net capital reduction)	
46.	Excess profits credit—based on income (line 43 plus line 45, if a net capital addition) (or line 43 minus line 45, if a net capital reduction)	$

[fol. 200] Schedule C—Excess Profits Credit—
Based on Invested Capital.

(Here follows 1 Photolithograph, side folio 200-201)

Page 6

Schedule C.—EXCESS PROFITS CREDIT—BASED ON INVESTED CAPITAL

Line No.			
	Equity Invested Capital at the Beginning of the Taxable Year (See Instructions for Schedule C, Items 1 to 12, inclusive)		
1.	Money paid in for stock, or as paid-in surplus, or as a contribution to capital		$ 320,000.00
2.	Property paid in for stock, or as paid-in surplus, or as a contribution to capital		
3.	Distributions of earnings and profits in stock of the corporation		
4.	(a) Accumulated earnings and profits	$ 326,834.76	
	(b) Adjustment for transferor's deficit under section 718 (c) (3)	$	
	(c) Increase or decrease under section 761 (d) (1) on account of intercorporate liquidation	$	
	(d) Accumulated earnings and profits (item 4 (a)) as adjusted by item 4 (b) and (c)		326,834.76
5.	25 percent of new capital paid in during a taxable year beginning after December 31, 1940		40,500.00
6.	Increase on account of intercorporate liquidation under section 761 (d) (2)		
7.	Deficit in earnings and profits of another corporation under section 718 (a) (7)		
8.	Total of lines 1 to 7		$ 686,334.76
9.	Less: Distributions made prior to the taxable year not out of accumulated earnings and profits	$	
10.	Earnings and profits of another corporation required to be deducted by section 718 (b) (3)		
11.	Decrease on account of intercorporate liquidation under section 761 (d) (2)		
12.	Deficit in earnings and profits in invested capital of another corporation (section 718 (b) (5))		
13.	Total of lines 9 to 12		
14.	Equity invested capital at beginning of taxable year (line 8 minus line 13)		$ 686,334.76
	Average Additions to Equity Invested Capital During the Taxable Year (See Instructions for Schedule C, Items 1 to 12, inclusive)		
15.	Money paid in for stock, or as paid-in surplus, or as a contribution to capital	$	
16.	Property paid in for stock, or as paid-in surplus, or as a contribution to capital		
17.	Distributions of earnings and profits (other than earnings and profits of the taxable year) in stock of a corporation (see line 24, below)		
18.	25 percent of new capital		
19.	Increase on account of intercorporate liquidation under section 761 (d) (2)		
20.	Deficit in earnings and profits of another corporation under section 718 (a) (7)		
21.	Total additions in lines 15 to 20		
22.	Total of lines 14 and 21		$ 686,334.76
	Average Reduction in Equity Invested Capital During the Taxable Year (See Instructions for Schedule C, Items 1 to 12, inclusive)		
23.	Distributions not out of earnings and profits of the taxable year	$	
24.	Stock distributions from accumulated earnings and profits at beginning of year (see line 17, above)		
25.	Decrease on account of intercorporate liquidation under section 761 (d) (2)		
26.	Deficit in earnings and profits included in invested capital of another corporation (section 718 (b) (5))		
27.	Total reductions in lines 23 to 26		
	(See Instructions for Schedule C, Items 28 to 41, inclusive)		
28.	Average equity invested capital (line 22 minus line 27)		$ 686,334.76
29.	Average borrowed capital (attach schedule)	$ 677,078.20	
30.	Average borrowed invested capital (50 percent of line 29)		338,539.14
31.	Average invested capital (line 28 plus line 30)		$ 937,873.90
32.	Total inadmissible assets	$	
33.	Total admissible and inadmissible assets	$	
34.	Percentage which line 32 is of line 33		%
35.	Reduction on account of inadmissible assets (..... percent of line 31)		
36.	Invested capital (line 31 minus line 35)		$ 937,873.90
37.	Portion of line 36 (not in excess of $5,000,000); and credit at 8 percent	$ 937,873.90	8% $ 75,029.91
38.	Portion of line 36 (over $5,000,000, but not over $10,000,000); and credit at 7 percent		7%
39.	Portion of line 36 (over $10,000,000, but not over $200,000,000); and credit at 6 percent		6%
40.	Portion of line 36 (over $200,000,000); and credit at 5 percent		5%
41.	Excess profits credit—based on invested capital (total of lines 37 to 40)		$ 75,029.91

5. 25 percent of new capital paid in during a taxable year beginning after December 31, 1940 — 40,500.00
6. Increase on account of intercorporate liquidation under section 761 (d) (2)
7. Deficit in earnings and profits of another corporation under section 718 (a) (7)
8. Total of lines 1 to 7 — $ 686,334.76
9. Less: Distributions made prior to the taxable year not out of accumulated earnings and profits
10. Earnings and profits of another corporation required to be deducted by section 718 (b) (3)
11. Decrease on account of intercorporate liquidation under section 761 (d) (2)
12. Deficit in earnings and profits in invested capital of another corporation (section 718 (b) (5))
13. Total of lines 9 to 12
14. Equity invested capital at beginning of taxable year (line 8 minus line 13) — $ 686,334.76
15. Money paid in for stock, or as paid-in surplus, or as a contribution to capital
16. Property paid in for stock, or as paid-in surplus, or as a contribution to capital
17. Distributions of earnings and profits (other than earnings and profits of the taxable year) in stock of the corporation (see line 24, below)
18. 25 percent of new capital
19. Increase on account of intercorporate liquidation under section 761 (d) (2)
20. Deficit in earnings and profits of another corporation under section 718 (a) (7)
21. Total additions in lines 15 to 20
22. Total of lines 14 and 21 — $ 686,334.76
23. Distributions not out of earnings and profits of the taxable year
24. Stock distributions from accumulated earnings and profits at beginning of year (see line 17, above)
25. Decrease on account of intercorporate liquidation under section 761 (d) (2)
26. Deficit in earnings and profits included in invested capital of another corporation (section 718 (b) (5))
27. Total reductions in lines 23 to 26
28. Average equity invested capital (line 22 minus line 27) — $ 686,334.76
29. Average borrowed capital (attach schedule) — $ 677,078.20
30. Average borrowed invested capital (50 percent of line 29) — 338,539.14
31. Average invested capital (line 28 plus line 30) — $ 937,873.90
32. Total inadmissible assets
33. Total admissible and inadmissible assets
34. Percentage which line 32 is of line 33 — %
35. Reduction on account of inadmissible assets (..... percent of line 31)
36. Invested capital (line 31 minus line 35) — $ 937,873.90
37. Portion of line 36 (not in excess of $5,000,000); and credit at 8 percent — $ 937,873.90 — 8% — $ 75,029.91
38. Portion of line 36 (over $5,000,000, but not over $10,000,000); and credit at 7 percent — 7%
39. Portion of line 36 (over $10,000,000, but not over $200,000,000); and credit at 6 percent — 6%
40. Portion of line 36 (over $200,000,000); and credit at 5 percent — 5%
41. Excess profits credit—based on invested capital (total of lines 37 to 40) — $ 75,029.91

[fol. 202] BEFORE THE TAX COURT OF THE UNITED STATES

PETITIONER'S EXHIBIT 21.

Amended United States Corporation Excess Profits Tax Return for Fiscal Year Ending September 30, 1944.

[fol. 204]

Lewyt Corporation

431 East 52nd Street, New York 22, N. Y.

Form 1121 Page 4 Line 29—Average Borrowed Capital

	Days		
Oct. 1, 1943 to June 30, 1944	274	$621,750.42	$170,359,615.08
July 1, 1944 to Sept. 11, 1944	43	821,750.42	59,987,780.66
Sept. 12, 1944 to Sept. 29, 1944	18	921,750.42	16,591,507.56
Sept. 30, 1944	1	871,750.42	871,750.42
Totals	366		$247,810,653.72
Average Borrowed Capital			$677,078.29

Amended Return

Lewyt Corporation

431 East 52nd Street, New York, N. Y.

Fiscal Year Ended September 30, 1944

Tentative Tax Computed Under Revenue Act of 1943

Excess Profits Tax

Excess Profits Net Income (Item 1—Form 1121 Attached)		$757,408.69
Less—Specific Exemption	$10,000.00	
Excess Profits Credit	76,629.91	86,629.91
Adjusted Excess Profits Net Income		$670,778.78
95% Tax		$637,239.84
Net Income Before Deducting Income Subject to Excess Profits Tax		$747,236.60
80% Tax		$597,789.28
Less Normal & Surtax		30,583.13
Excess Profits Tax—Tentative		$567,206.15

[fol. 205]

Normal Tax & Surtax		
Net Income	$747,236.60	
Less Income Subject to Excess Profits Tax	670,778.78	
Normal Tax & Surtax Net Income		$ 76,457.82
Normal Tax 24%	$ 18,349.88	
Surtax 16%	12,233.25	
Total Normal Tax & Surtax—Tentative		$ 30,583.13
Recapitulation		
Normal Tax & Surtax:		
92/365 of Tentative Tax under 1942 Act $28,583.13	$ 7,204.51	
273/365 of Tentative Tax under 1943 Act $30,583.13	22,874.50	
Total Normal Tax & Surtax		$ 30,079.01
Excess Profits Tax:		
92/365 of Tentative Tax under 1942 Act $569,206.15	$143,471.14	
273/365 of Tentative Tax under 1942 Act $567,206.15	424,239.12	
Total Excess Profits Tax	$567,710.26	
Less Credit of Debt Retirement (40% of $50,000)	20,000.00	
Net Excess Profits Tax		$547,710.26
Post War Refund:		
10% of Excess Profits Tax of $567,710.26	$ 56,771.03	
Less Credit for Debt Retirement	20,000.00	
Post War Refund		$ 36,771.03

[fol. 206] Schedule B—Excess Profits Credit—Based on Income.

(Here follows 1 Photolithograph, side folio 207)

(Here follow 2 Photolithographs, side folios 203, 203a)

Form 1121
Treasury Department
Internal Revenue Service

AMENDED RETURN

UNITED STATES
CORPORATION EXCESS PROFITS TAX RETURN
For Calendar Year 1943

8 52 1943

or fiscal year beginning Oct. 1, 1943, and ending Sept. 30, 1944

File Code
Serial No. 11 406903
District 3

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

LEVYT CORPORATION

431 East 52nd Street

New York 22 N. Y.

Business group serial number entered on page 1, Form 1120

Cash Check M. O.
First payment
$

THE TAX COURT OF THE U.S.
DIV. 1 DOCKET 2515
ADMITTED IN EVIDENCE
OCT 30 1951
PETITIONER'S EXHIBIT 21
RESPONDENT'S

THE TAX COURT OF THE U.S.
DIV. DOCKET
ADMITTED IN EVIDENCE
OCT 30 1951
PETITIONER'S EXHIBIT 14
RESPONDENT'S

RECEIVED
No. 53
SEP 14 1945
COLLECTOR OF INTERNAL REVENUE
THIRD DIST. N.Y.

EXCESS PROFITS TAX COMPUTATION

	Column 1 Income Credit Method	Column 2 Invested Capital Credit Method
1. Excess profits net income (from line 7, Schedule A)		$ 757,408.69
2. Specific exemption	$ 5,000	$ 5,000
3. Excess profits credit—based on income (from line 6, Schedule B)	XXXXXXX	76,629.91
4. Excess profits credit—based on invested capital (line 41, Schedule C)	XXXXXXX	$ 81,629.91
5. Unused excess profits credit adjustment (attach schedule)	$	$ 675,778.78
6. Total of items 3 to 5	$	$ 675,778.78
7. Difference between items 1 and 6 (enter item 7, column 2, when applicable)		$ 608,200.90
8. Adjusted excess profits net income		$ 747,236.60
9. 90 percent of item 8		
10. Net income (computed without regard to the credit provided by section 26 (e)) (item 35, page 1, Form 1120)		$ 747,236.60
11. Less: (a) Dividends received credit (85 percent of total of column 2, Schedule E, Form 1120 (excluding dividends received on certain preferred stock of a public utility), but not in excess of 85 percent of item 10 above)	$	
(b) Dividends paid on certain preferred stocks if taxpayer is a public utility (line 20, page 2, Form 1120)		
12. Surtax net income (computed without regard to the credit provided by section 26 (e))		$ 747,236.60
13. 80 percent of item 12		597,789.28
14. Income tax under Chapter 1 (other than section 102) for the taxable year (item 41, page 1, Form 1120)		28,583.13
15. Excess of item 13 over item 14		$ 569,206.15
16. Item 9, or item 15, whichever is lesser		$ 569,206.15
17. Amount deferred by reason of the application of section 710 (a) (5) (relating to abnormality under section 722) (attach schedule)		$
18. Excess profits tax:		
(a) Item 16 minus item 17	$ 569,209.15	
(b) If schedule is filed under question (g), page 2, amount of tax as computed in such schedule		
(c) Item 18 (a) or item 18 (b), whichever is applicable		$ 569,206.15
19. Less: Credit for income taxes paid to a foreign country or United States possession allowed to a domestic corporation (portion not used in computing item 42, page 1, Form 1120)	Amd Tax 549,206.15	
20. Item 18 (c) minus item 19	Orig Tax 605 561.59	$ 569,206.15
Less: Credit for debt retirement (item 28, below)	Tax due none	20,000.00
21. 20 minus item 21		$ 549,206.15
23. Adjustment, if any, due to application of section 734 (adjustment in case of position inconsistent with prior income tax liability) (attach schedule)		
24. Excess profits tax due (item 22 plus item 23, or item 22 minus item 23, whichever is applicable)		$ 549,206.15

POST-WAR REFUND OF EXCESS PROFITS TAX AND CREDIT FOR DEBT RETIREMENT

25. Balance excess profits tax (item 18 (c), above)		$ 569,206.15
26. Credit allowable under sections 780 and 781 (10 percent of item 25) (but in cases where item 19 is applicable, see Specific Instructions 25-26)		$ 56,920.62
27. Less: amounts paid on indebtedness or net reduction in indebtedness under section 783 (b) (2)	$ 50,000.00	
28. Credit for debt retirement allowable under section 783 (40 percent of item 27, but not in excess of 10 percent of item 25)		20,000.00
29. Net post-war refund credit (item 26 minus item 28)		$ 36,920.62

We, the undersigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return (including any accompanying schedules and statements) has been examined by him and is, to the best of his knowledge and belief, a true, correct, and complete return, made in good faith, for the taxable year stated, pursuant to the Internal Revenue Code and the regulations issued thereunder.

Subscribed and sworn to before me this 14 day of September, 1945.

Notary Public, N.Y. Co.
Cert. Filed in [illegible]
Commission Expires March 30, 1946

NOTARIAL SEAL

Helga Dewey
(Signature of officer administering oath)

(Title)

CORPORATE SEAL

(President or other principal officer) (state title)

(Treasurer, Assistant Treasurer, or Chief Accounting Officer) (state title)

I/we swear (or affirm) that I/we prepared this return for the person named herein and that this return (including any accompanying schedules and statements) is a true, correct, and complete statement of all the information respecting the excess profits tax liability of the person for whom this return has been prepared of which I/we have any knowledge.

Subscribed and sworn to before me this 14 day of September, 1945.

(Signature of person preparing the return)

NOTARIAL SEAL

Helga Dewey
(Signature of officer administering oath)

Notary Public, N.Y. Co. No. 42
Cert. Filed in [illegible] Co. No. 42
Commission Expires March 30, 1946
(Title)

(Address of person preparing the return)

Leon T. Brown
(Name of firm or employer, if any)

Page 2

QUESTIONS

(a) Date of incorporation December, 1942 (b) State or country New York

(c) Collector's office in which your income tax return for the taxable year was filed 3rd New York

(d) Is this a consolidated return? No If so, procure from the collector Form 851, Affiliations Schedule, which shall be filled in, sworn to, and filed as a part of the consolidated income tax return.

(e) In computing the excess profits credit under the invested capital method, do you elect to include in excess profits net income interest received on, reduced by the amount of amortizable bond premium under section 125 attributable to, all Government obligations described in section 22(b)(4) of the Internal Revenue Code? (Answer "yes" or "no") Yes

(f) Are you a transferor or transferee upon an exchange as defined by section 760 or 761 of the Internal Revenue Code? (Answer "yes" or "no") No

(g) Does this return involve an adjustment of the excess profits tax liability due to the application of the sections specified in (1) below? (Answer "yes" or "no") No If answer is "yes":

(1) Check the appropriate sections and submit schedules showing computation: 710(a)(4) ☐; 721 ☐; 726 ☐; 731 ☐; 735(b) ☐; 735(c) ☐; 736(a) ☐; 736(b) ☐. (See General Instructions E, F, G, H, and I.) (Enter amount of excess profits tax as item 18 (b), page 1.)

(2) From the schedules submitted under (1) above, enter any tax adjustment which results from the application of each of the following sections: 721, $ ....; 726, $ ....; 731, $ ....

(3) From the schedules submitted under (1) above, enter any income adjustment which results from the application of each of the following sections: 721, $ ....; 731, $ ....; 735(b), $ ....; 735(c), $ ....

(h) State amount of total assets as of the end of the taxable year. (From Form 1120, page 4, line 8, last column), $ 2,806,034.14

Schedule A. EXCESS PROFITS NET INCOME COMPUTATION

Line No.		Column 1 Income Credit Method	Column 2 Invested Capital Credit Method
1.	Normal-tax net income (computed without allowance of credit for income subject to excess profits tax and without allowance of dividends received credit) (item 37, page 1, Form 1120)	$	$ 747,236.60
2.	Net short-term capital gain (do not enter net short-term capital loss)		
3.	Adjustment to net operating loss deduction		
4.	Decrease in deductions limited by income		
5.	80 percent of interest on borrowed capital	XXXXXXX XX	10,172.09
6.	Interest on Government obligations (see question (e) above, for election)	XXXXXXX XX	
7.	Total of lines 1 to 6	$	$ 757,408.69
8.	Net gain from sale or exchange of capital assets (item 12 (a), page 1, Form 1120)	$	$
9.	Income from retirement or discharge of bonds, etc.		
10.	Refunds and interest on Agricultural Adjustment Act taxes		
11.	Recoveries of bad debts		
12.	Increase in deductions limited by income		
13.	(a) Dividends received credit adjustment (item 13, page 1, Form 1120, excluding dividends received from foreign corporations)		XXXXXXX XX
	(b) Dividends received credit adjustment (item 13, page 1, Form 1120, excluding dividends received from foreign personal holding companies and dividends received on stock held primarily for sale to customers by a dealer in securities)	XXXXXXX XX	
14.	Nontaxable income of certain industries with depletable resources		
15.	Total of lines 8 to 14	$	$ none
16.	Excess profits tax net income computed without regard to deductions applicable to life insurance companies (line 7 minus line 15)	$	$ 757,408.69
17.	Deductions applicable to life insurance companies		
18.	Excess profits net income computed under income credit method or invested capital credit method (line 16, or line 16 minus line 17 in case of a life insurance company)	$	$ 757,408.69

(f) Are you a transferor or transferee upon an exchange as defined by section 760 or 761 of the Internal Revenue Code? (Answer "yes" or "no") No

(g) Does this return involve an adjustment of the excess profits tax liability due to the application of the sections specified in (1) below? (Answer "yes" or "no") No If answer is "yes":

(1) Check the appropriate sections and submit schedules showing computation: 710(a)(4) ☐; 721 ☐; 726 ☐; 731 ☐; 735(b) ☐; 735(c) ☐; 736(a) ☐; 736(b) ☐. (See General Instructions E, F, G, H, and I.) (Enter amount of excess profits tax as item 18 (b), page 1.)

(2) From the schedules submitted under (1) above, enter any tax adjustment which results from the application of each of the following sections: 721, $ ....; 726, $ ....; 731, $ ....

(3) From the schedules submitted under (1) above, enter any income adjustment which results from the application of each of the following sections: 721, $ ....; 731, $ ....; 735(b), $ ....; 735(c), $ ....

(h) State amount of total assets as of the end of the taxable year. (From Form 1120, page 4, line 8, last column), $ 2,806,034.14

Schedule A. EXCESS PROFITS NET INCOME COMPUTATION

Line No.		Column 1 Income Credit Method	Column 2 Invested Capital Credit Method
1.	Normal-tax net income (computed without allowance of credit for income subject to excess profits tax and without allowance of dividends received credit) (item 37, page 1, Form 1120)	$	$ 747,236.60
2.	Net short-term capital gain (do not enter net short-term capital loss)		
3.	Adjustment to net operating loss deduction		
4.	Decrease in deductions limited by income		
5.	80 percent of interest on borrowed capital	XXXXXXX XX	10,172.09
6.	Interest on Government obligations (see question (e) above, for election)	XXXXXXX XX	
7.	Total of lines 1 to 6	$	$ 757,408.69
8.	Net gain from sale or exchange of capital assets (item 12 (a), page 1, Form 1120)	$	$
9.	Income from retirement or discharge of bonds, etc.		
10.	Refunds and interest on Agricultural Adjustment Act taxes		
11.	Recoveries of bad debts		
12.	Increase in deductions limited by income		
13.	(a) Dividends received credit adjustment (item 13, page 1, Form 1120, excluding dividends received from foreign corporations)		XXXXXXX XX
	(b) Dividends received credit adjustment (item 13, page 1, Form 1120, excluding dividends received from foreign personal holding companies and dividends received on stock held primarily for sale to customers by a dealer in securities)	XXXXXXX XX	
14.	Nontaxable income of certain industries with depletable resources		
15.	Total of lines 8 to 14	$	$ none
16.	Excess profits tax net income computed without regard to deductions applicable to life insurance companies (line 7 minus line 15)	$	$ 757,408.69
17.	Deductions applicable to life insurance companies		
18.	Excess profits net income computed under income credit method or invested capital credit method (line 16, or line 16 minus line 17 in case of a life insurance company)	$	$ 757,408.69

Schedule B.—EXCESS PROFITS CREDIT—BASED ON INCOME

TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1939, AND BEFORE JANUARY 1, 1940
(If additional columns are required, attach separate schedule)

Line No.		1. Year Ended ..., 19..	2. Year Ended ..., 19..	3. Year Ended ..., 19..	4. Year Ended ..., 19..
1.	Normal-tax (or special-class) net income	$	$	$	$
2.	Net capital loss used in computing line 1				
3.	Securities which are capital assets deducted in computing line 1 as bad debts or as stock determined to be worthless (for taxable years beginning prior to January 1, 1938)				
4.	Net loss from sale or exchange of property other than capital assets deducted in computing line 1 (for taxable years beginning after December 31, 1937)				
5.	Net loss from involuntary conversion of property deducted in computing line 1				
6.	Total of lines 1 to 5	$	$	$	$
7.	Net capital gain used in computing line 1	$	$	$	$
8.	Net gain from sale or exchange of property other than capital assets used in computing line 1 (for taxable years beginning after December 31, 1937)				
9.	Net gain from involuntary conversion of property used in computing line 1				
10.	Total of lines 7 to 9	$	$	$	$
11.	Difference between lines 6 and 10	$	$	$	$
12.	Net gain from sale or exchange of capital assets after considering net capital loss carry-over				
13.	Net gain from sale, exchange, or involuntary conversion of property other than capital assets				
14.	Total of lines 11 to 13	$	$	$	$
15.	Net loss from sale, exchange, or involuntary conversion of property other than capital assets	$	$	$	$
16.	Stock and securities of affiliated corporations which became worthless during the taxable year (if included in line 2, 3, or 7)				
17.	Total of lines 15 and 16	$	$	$	$
18.	Normal-tax (or special-class) net income after applying section 711 (b) (2) (line 14 minus line 17)	$	$	$	$
19.	Net short-term capital gain after considering net capital loss carry-over (do not enter net short-term capital loss)				
20.	Dividends received credit				
21.	Deductions on account of retirement or discharge of bonds, etc.				
22.	Casualty, demolition, and similar losses not taken into account in computing line 12, 13, or 15				
23.	Repayment of processing tax to vendee				
24.	(a) Abnormal judgment liabilities, etc. (attach statement)				
	(b) Abnormal expenditures for intangible drilling and development costs (attach statement)				
	(c) Other abnormal deductions (attach statement)				
25.	Capitalization of expenditures for advertising or promotion of goodwill (attach statement)				
26.	Total of lines 18 to 25	$	$	$	$
27.	Income from retirement or discharge of bonds, etc.	$	$	$	$
28.	Dividends received from domestic corporations				
29.	Net gain from sale or exchange of capital assets after considering net capital loss carry-over (line 12, above)				
	Total of lines 27 to 29	$	$	$	$
31.	Excess profits net income (line 26 minus line 30)	$	$	$	$
32.	Net aggregate of columns 1, 2, 3, and 4				$
33.	Increase in lowest year in base period (attach statement)				
34.	Total of lines 32 and 33				$
35.	Average base period net income—General average (line 34 divided by number of months in base period, multiplied by 12)				$

(Fill in lines 36 to 42 for computation of average base period net income where there are increased earnings in last half of base period)

36.	Net aggregate of columns 3 and 4, line 31 (see instruction regarding limitation applicable to taxable year ending after May 31, 1940)	$	
37.	Net aggregate of columns 1 and 2, line 31		
38.	Excess of line 36 over line 37	$	
39.	One-half of line 38		
40.	Line 36 plus line 39	$	
41.	Line 40 divided by number of months in second half of base period, multiplied by 12	$	
42.	Average base period net income—Increased earnings in last half of base period (line 41, or the highest excess profits net income for any taxable year in the base period, whichever is lesser)		$
43.	95 percent of line 35 or line 42, whichever is greater		$
44.	Net capital addition, $...; or net capital deduction, $... (attach statement).		
45.	8 percent of line 44, if a net capital addition (or 6 percent of line 44, if a net capital reduction)		
46.	Excess profits credit—based on income (line 43 plus line 45, if a net capital addition) (or line 43 minus line 45, if a net capital reduction)		$

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Form 1121
Treasury Department
Internal Revenue Service

Page 1

UNITED STATES
CORPORATION EXCESS PROFITS TAX RETURN
For Calendar Year 1944

1944

or fiscal year beginning Oct. 1, 1944, and ending Sept. 30, 1945

PRINT PLAINLY CORPORATION'S NAME AND ADDRESS

LENXT CORPORATION (Name) MAY 1946

431 East 52nd Street (Street and number)

New York (City or town, postal zone number) New York (State)

Business group serial number entered on page 1, Form 1120

File Code
Serial No.
District
(Cashier's stamp)

Cash Check M. O.
First payment
$

THE TAX COURT OF THE U.S.
DIV. 1 DOCKET 8151
ADMITTED IN EVIDENCE
NEW YORK
OCT 30 1951
PETITIONER'S EXHIBIT 25

APR 15 1946
INTERNAL REVENUE
Hibill Dist.

EXCESS PROFITS TAX COMPUTATION

Item and Instruction No.		Column 1 Income Credit Method	Column 2 Invested Capital Credit Method
1.	Excess profits net income (line 18, Schedule A)	2078	$ 1,236,9[illegible]
2.	Specific exemption	$ 10,000	$ 10,000
3.	Excess profits credit—based on income (line 43, Schedule B) Acc. Dist.	x x x x x x x	x x
4.	Excess profits credit—based on invested capital (line 19, Schedule C) Internal Revenue	x x x x x x x	x x 64,421.41
5.	Unused excess profits credit adjustment (attach schedule)		
6.	Total of items 2 to 5	$	$ 74,421.41
7.	Difference between item 1 and item 6	$	$ 2,[illegible]
8.	Adjusted excess profits net income (item 7, column 1, or item 7, column 2, whichever is applicable) OVERASSESSMENT TENTATIVE ALLOWANCE CB		$ 1,162,43[illegible]
9.	95 percent of item 8		$ 1,104,35[illegible]
10.	Net income (item 36, page 1, Form 1120) $612 SUL 13		$ 1,225,641.63
11.	Less: (a) Dividends received credit (85 percent of total of column 2, Schedule E, Form 1120, excluding dividends received on certain preferred stock of a public utility), but not in excess of 85 percent of item 10 OVERASSESSMENT TENTATIVE ALLOWANCE CB $ 875.9		
	(b) Credit for dividends paid on certain preferred stocks if taxpayer is a public utility (20 percent of [illegible] Form 1120)		
12.	Surtax net income (computed without regard to credit provided in section 26 (e) (sum of lines 18 and 21, page 2, Form 1120) and without regard to 80 percent limitation credit provided in section 26 (h))		$ 1,225,641.63
13.	80 percent of item 12		330,513.30
14.	Income tax under Chapter 1 (other than section 102) for the taxable year (item 42, page 1, Form 1120)		23,715.48
15.	Excess of item 13 over item 14		$ 956,797.32
16.	Item 9, or item 15, whichever is lesser		$ 956,797.32
17.	Amount deferred by reason of the application of section 710 (a) (5) (relating to abnormality under section 722) (attach schedule)		$
18.	Excess profits tax: (a) Item 16 minus item 17	$ 956,797.32	
	(b) If schedule is filed under question (g), page 2, amount of tax as computed in such schedule		
	(c) Item 18 (a) or item 18 (b), whichever is applicable		$ 956,797.32
19.	Less: Credit for income taxes paid to a foreign country or United States possession allowed to a domestic corporation (portion not used in computing item 43, page 1, Form 1120)		
20.	Item 18 (c) minus item 19		$ [illegible]
21.	Less: Credit for debt retirement (item 28, below)		[illegible]
22.	Item 20 minus item 21		$
23.	Amount, if any, due to application of section 734 (adjustment in case of position inconsistent with prior income tax liability) (attach schedule)		
24.	Excess profits tax due (item 22 plus item 23, or item 22 minus item 23, whichever is applicable)		$ [illegible]

POST-WAR REFUND OF EXCESS PROFITS TAX AND CREDIT FOR DEBT RETIREMENT

25.	Balance of excess profits tax (item 18 (c), above)	$
26.	Credit allowable under sections 780 and 781 (10 percent of item 25) (but in cases where item 19 is applicable, see Specific Instructions 25-29)	$
27.	Lesser of amounts paid on indebtedness or net reduction in indebtedness under section 783 (b) (2)	$
28.	Credit for debt retirement allowable under section 783 (40 percent of item 27, but not in excess of 10 percent of item 25)	
29.	Net post-war refund credit (item 26 minus item 28)	$

We, the undersigned, president (or vice president, or other principal officer) and treasurer (or assistant treasurer, or chief accounting officer) of the corporation for which this return is made, being severally duly sworn, each for himself deposes and says that this return (including any accompanying schedules and statements) has been examined by him and is, to the best of his knowledge and belief, a true, correct, and complete return, made in good faith for the taxable year stated, pursuant to the Internal Revenue Code and the regulations issued thereunder.

Subscribed and sworn to before me this 15th day of April, 1946

NOTARIAL SEAL

HENRIETTA S. ROSENBERG
NOTARY PUBLIC, KINGS COUNTY
New York Co. Clk's No. 303, Reg. No. 3927-S-3
Kings Co. Clk's No. 510, Reg. No. 5097-S-3
Certificate filed in New York County
Kings County Term Expires March 30, 1946

(Signature of officer administering oath) (Title)

CORPORATE SEAL

(President or other principal officer) (State title)

(Treasurer, Assistant Treasurer, or Chief Accounting Officer) (State title)

I/we swear (or affirm) that I/we prepared this return for the person named herein and that the return (including any accompanying schedules and statements) is a true, correct, and complete statement of all the information respecting the excess profits tax liability of the person for whom this return has been prepared of which I/we have any knowledge.

Subscribed and sworn to before me this 15th day of April, 1946

NOTARIAL SEAL

HENRIETTA S. ROSENBERG
NOTARY PUBLIC, KINGS COUNTY
New York Co. Clk's No. 303, Reg. No. 3927-S-3
Kings Co. Clk's No. 510, Reg. No. 5097-S-3
Certificate filed in New York County
Kings County Term Expires March 30, 1946

(Signature of officer administering oath) (Title)

(Signature of person preparing the return)

(Signature of person preparing the return)

16—41119-1 (Name of firm or employer, if any)

[fol. 208] Schedule C—Excess Profits Credit—
Based on Invested Capital.

Page 2

QUESTIONS

(a) Date of incorporation December 1942 (b) State or country New York

(c) Collector's office in which your income tax return for the taxable year was filed 3rd New York

(d) Is this a consolidated return? No If so, procure from the collector Form 851, Affiliations Schedule, which shall be filed in, sworn to, and filed as a part of the consolidated income tax return.

(e) In computing the excess profits credit under the invested capital method, do you elect to include in excess profits net income interest received on, reduced by the amount of amortizable bond premium under section 125 attributable to, all Government obligations described in section 22(b)(4) of the Internal Revenue Code? (Answer "yes" or "no") .....

(f) Are you a transferor or transferee upon an exchange as defined by section 760 or 761 of the Internal Revenue Code? (Answer "yes" or "no") No

(g) Does this return involve an adjustment of the excess profits tax liability due to the application of the sections specified in (1) below? (Answer "yes" or "no") No If answer is "yes":

(1) Check the appropriate sections and submit schedules showing computation: 710(a)(4) ☐; 721 ☐; 726 ☐; 731 ☐; 735(b) ☐; 735(c) ☐; 736(a) ☐; 736(b) ☐. (See General Instructions E, F, G, H, and I.) (Enter amount of excess profits tax as Item 18 (b), page 1.)

(2) From the schedules submitted under (1) above, enter any tax adjustment which results from the application of each of the following sections: 721, $ .....; 726, $.....; 731, $.....

(3) From the schedules submitted under (1) above, enter any income adjustment which results from the application of each of the following sections: 721, $.....; 731, $.....; 735(b), $.....; 735(c), $.....

(h) State amount of total assets as of the end of the taxable year. (From Form 1120, page 4, line 8, last column), $2,628,221.07

(i) Has a constructive average base period net income under section 722 been used in computing the excess profits credit used on this return? No If the answer is "yes," was such constructive average base period net income finally determined? ..... Or, if not finally determined, is it used pursuant to permission granted by the Commissioner? ..... If the answer to the first question is "yes," the following questions should be answered and the required information furnished:

(1) Is the amount of the constructive average base period net income so used the same as that which was finally determined or permitted? ..... If the answer is "no," attach statement setting forth reasons for the variance and the amount thereof.

(2) If the constructive average base period net income resulted from the application of section 722 (b) (4) or (5) or section 722 (c), are the facts and circumstances different in the taxable year from the facts and circumstances with respect to which the claim for relief was first allowed? ..... If so, attach statement containing a brief description of the difference and an account of its effect upon the business of the taxpayer for the taxable year.

(3) State the amount of the excess profits credit for the taxable year computed without regard to section 722. $.....

(j) Is any unused excess profits credit adjustment computed with the use of a constructive average base period net income? No If the answer is "yes," attach schedule showing computation.

Schedule A. - EXCESS PROFITS NET INCOME COMPUTATION

Line No.		Column 1 Income Credit Method		Column 2 Invested Capital Credit Method	
1.	Normal-tax net income (computed without allowance of credit for income subject to excess profits tax and without allowance of dividends received credit) (item 28, page 1, Form 1120)	$		$ 1,225,641	63
2.	Net short-term capital gain (do not enter net short-term capital loss)				
3.	Adjustment to net operating loss deduction				
4.	Decrease in deductions limited by income				
5.	50 percent of interest on borrowed capital	x x x x x x x	x x	11,262	18
6.	Interest on Government obligations (see question (e) above, for election)	x x x x x x x	x x		
7.	Total of lines 1 to 6	$		$ 1,236,903	81
8.	Net gain from sale or exchange of capital assets (item 12 (a) plus item 28, page 1, Form 1120)	$		$	
9.	Income from retirement or discharge of bonds, etc.				
10.	Refunds and interest on Agricultural Adjustment Act taxes				
11.	Recoveries of bad debts				
12.	Increase in deductions limited by income				
13.	(a) Dividends received credit adjustment (item 13, page 1, Form 1120, excluding dividends received from foreign corporations)			x x x x x x x	x
	(b) Dividends received credit adjustment (item 13, page 1, Form 1120, excluding dividends received from foreign personal holding companies and dividends received on stock held primarily for sale to customers by a dealer in securities)	x x x x x x x	x x		
14.	Nontaxable income of certain industries with depletable resources				
15.	Total of lines 8 to 14	$		$	
16.	Excess profits tax net income computed without regard to deductions applicable to life insurance companies (line 7 minus line 15)	$		$ 1,236,903	81
17.	Deductions applicable to life insurance companies				
18.	Excess profits net income computed under income credit method or invested capital credit method (line 16, or line 16 minus line 17 in case of a life insurance company)	$		$ 1,236,903	81

721, $.....; 731, $.....; 735(b), $.....; 735(c), $.....

(h) State amount of total assets as of the end of the taxable year. (From Form 1120, page 4, line 8, last column), $2,628,221.07

(i) Has a constructive average base period net income under section 722 been used in computing the excess profits credit used on this return? No If the answer is "yes," was such constructive average base period net income finally determined? ..... Or, if not finally determined, is it used pursuant to permission granted by the Commissioner? ..... If the answer to the first question is "yes," the following questions should be answered and the required information furnished:

(1) Is the amount of the constructive average base period net income so used the same as that which was finally determined or permitted? ..... If the answer is "no," attach statement setting forth reasons for the variance and the amount thereof.

(2) If the constructive average base period net income resulted from the application of section 722 (b) (4) or (5) or section 722 (c), are the facts and circumstances different in the taxable year from the facts and circumstances with respect to which the claim for relief was first allowed? ..... If so, attach statement containing a brief description of the difference and an account of its effect upon the business of the taxpayer for the taxable year.

(3) State the amount of the excess profits credit for the taxable year computed without regard to section 722. $.....

(j) Is any unused excess profits credit adjustment computed with the use of a constructive average base period net income? No If the answer is "yes," attach schedule showing computation.

Schedule A. - EXCESS PROFITS NET INCOME COMPUTATION

Line No.		Column 1 Income Credit Method		Column 2 Invested Capital Credit Method	
1.	Normal-tax net income (computed without allowance of credit for income subject to excess profits tax and without allowance of dividends received credit) (item 28, page 1, Form 1120)	$		$ 1,225,641	63
2.	Net short-term capital gain (do not enter net short-term capital loss)				
3.	Adjustment to net operating loss deduction				
4.	Decrease in deductions limited by income				
5.	50 percent of interest on borrowed capital	x x x x x x x	x x	11,262	18
6.	Interest on Government obligations (see question (e) above, for election)	x x x x x x x	x x		
7.	Total of lines 1 to 6	$		$ 1,236,903	81
8.	Net gain from sale or exchange of capital assets (item 12 (a) plus item 28, page 1, Form 1120)	$		$	
9.	Income from retirement or discharge of bonds, etc.				
10.	Refunds and interest on Agricultural Adjustment Act taxes				
11.	Recoveries of bad debts				
12.	Increase in deductions limited by income				
13.	(a) Dividends received credit adjustment (item 13, page 1, Form 1120, excluding dividends received from foreign corporations)			x x x x x x x	x
	(b) Dividends received credit adjustment (item 13, page 1, Form 1120, excluding dividends received from foreign personal holding companies and dividends received on stock held primarily for sale to customers by a dealer in securities)	x x x x x x x	x x		
14.	Nontaxable income of certain industries with depletable resources				
15.	Total of lines 8 to 14	$		$	
16.	Excess profits tax net income computed without regard to deductions applicable to life insurance companies (line 7 minus line 15)	$		$ 1,236,903	81
17.	Deductions applicable to life insurance companies				
18.	Excess profits net income computed under income credit method or invested capital credit method (line 16, or line 16 minus line 17 in case of a life insurance company)	$		$ 1,236,903	81

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(Here follows 1 Photolithograph, side folios 209-221)

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Schedule C—EXCESS PROFITS CREDIT—BASED ON INVESTED CAPITAL

Line No.	Equity Invested Capital at the Beginning of the Taxable Year (See instructions for Schedule C, lines 1 to 12, inclusive)		
1.	Money paid in for stock, or as paid-in surplus, or as a contribution to capital		$ 250,000.00
2.	Property paid in for stock, or as paid-in surplus, or as a contribution to capital		
3.	Distributions of earnings and profits in stock of the corporation		
4.	(a) Accumulated earnings and profits	$ 306,834.76	
	(b) Adjustment for transferor's deficit under section 718 (c) (5)	$	
	(c) Increase or decrease under section 761 (d) (1) on account of intercorporate liquidation	$	
	(d) Accumulated earnings and profits (item 4 (a)) as adjusted by item 4 (b) and (c)		306,834.76
5.	25 percent of new capital paid in during a taxable year beginning after December 31, 1940		62,500.00
6.	Increase on account of intercorporate liquidation under section 761 (d) (2)		
7.	Deficit in earnings and profits of another corporation under section 718 (a) (7)		
8.	Total of lines 1 to 7		$ 619,334.76
9.	Less: Distributions made prior to the taxable year not out of accumulated earnings and profits	$	
10.	Earnings and profits of another corporation required to be deducted by section 718 (b) (3)		
11.	Decrease on account of intercorporate liquidation under section 761 (d) (2)		
12.	Deficit in earnings and profits in invested capital of another corporation (section 718 (b) (5))		
13.	Total of lines 9 to 12		
14.	Equity invested capital at beginning of taxable year (line 8 minus line 13)		$ 619,334.76
	Average Addition to Equity Invested Capital During the Taxable Year (See instructions for Schedule C, lines 1 to 12, inclusive)		
15.	Money paid in for stock, or as paid-in surplus, or as a contribution to capital	$	
16.	Property paid in for stock, or as paid-in surplus, or as a contribution to capital		
17.	Distributions of earnings and profits (other than earnings and profits of the taxable year) in stock of the corporation (see line 24, below)		
18.	25 percent of new capital		
19.	Increase on account of intercorporate liquidation under section 761 (d) (2)		
20.	Deficit in earnings and profits of another corporation under section 718 (a) (7)		
21.	Total additions in lines 15 to 20		
22.	Total of lines 14 and 21		$ 619,334.76
	Average Reduction in Equity Invested Capital During the Taxable Year (See instructions for Schedule C, lines 1 to 12, inclusive)		
23.	Distributions not out of earnings and profits of the taxable year	$	
24.	Stock distributions from accumulated earnings and profits at beginning of year (see line 17, above)		
25.	Decrease on account of intercorporate liquidation under section 761 (d) (2)		
26.	Deficit in earnings and profits included in invested capital of another corporation (section 718 (b) (5))		
27.	Total reductions in lines 23 to 26		
	(See instructions for Schedule C, lines 28 to 41, inclusive)		
28.	Average equity invested capital (line 22 minus line 27)		$ 619,334.76
29.	Average borrowed capital (attach schedule)	$ 677,078.29	
30.	Average borrowed invested capital (50 percent of line 29)		338,539.14
31.	Average invested capital (line 28 plus line 30)		$ 957,873.90
32.	Total inadmissible assets	$	
33.	Total admissible and inadmissible assets	$	
34.	Percentage which line 32 is of line 33		%
35.	Reduction on account of inadmissible assets (percent of line 31)		
36.	Invested capital (line 31 minus line 35)		$ 957,873.90
37.	Portion of line 36 (not in excess of $5,000,000); and credit at 8 percent	$ 957,873.90	8% $ 76,629.91
38.	Portion of line 36 (over $5,000,000, but not over $10,000,000); and credit at 7 percent		7%
39.	Portion of line 36 (over $10,000,000, but not over $200,000,000); and credit at 6 percent		6%
40.	Portion of line 36 (over $200,000,000); and credit at 5 percent		5%
41.	Excess profits credit—based on invested capital (total of lines 37 to 40)		$ 76,629.91

7. Deficit in earnings and profits of another corporation under section 718 (a) (7)
8. Total of lines 1 to 7 — $ 619,334.76
9. Less: Distributions made prior to the taxable year not out of accumulated earnings and profits — $
10. Earnings and profits of another corporation required to be deducted by section 718 (b) (3)
11. Decrease on account of intercorporate liquidation under section 761 (d) (2)
12. Deficit in earnings and profits in invested capital of another corporation (section 718 (b) (5))
13. Total of lines 9 to 12
14. Equity invested capital at beginning of taxable year (line 8 minus line 13) — $ 619,334.76

Average Addition to Equity Invested Capital During the Taxable Year (See instructions for Schedule C, lines 1 to 12, inclusive)

15. Money paid in for stock, or as paid-in surplus, or as a contribution to capital — $
16. Property paid in for stock, or as paid-in surplus, or as a contribution to capital
17. Distributions of earnings and profits (other than earnings and profits of the taxable year) in stock of the corporation (see line 24, below)
18. 25 percent of new capital
19. Increase on account of intercorporate liquidation under section 761 (d) (2)
20. Deficit in earnings and profits of another corporation under section 718 (a) (7)
21. Total additions in lines 15 to 20
22. Total of lines 14 and 21 — $ 619,334.76

Average Reduction in Equity Invested Capital During the Taxable Year (See instructions for Schedule C, lines 1 to 12, inclusive)

23. Distributions not out of earnings and profits of the taxable year — $
24. Stock distributions from accumulated earnings and profits at beginning of year (see line 17, above)
25. Decrease on account of intercorporate liquidation under section 761 (d) (2)
26. Deficit in earnings and profits included in invested capital of another corporation (section 718 (b) (5))
27. Total reductions in lines 23 to 26

209=221

[fol. 222] BEFORE THE TAX COURT OF THE UNITED STATES

PETITIONER'S EXHIBIT 25, ADMITTED IN EVIDENCE.

United States Corporation Excess Profits Tax Return
for Fiscal Year Ending September 30, 1945.

[fol. 244] UNITED STATES COURT OF APPEALS
For the Second Circuit, October Term, 1953.

No. 184

Docket No. 22871

LEWYT CORPORATION (Now known as Lewyt Manufacturing Corporation),

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

OPINION—Argued April 15, 1954—Decided July 14, 1954

Before Clark, Hincks and Harlan, Circuit Judges

Petition to review a decision of the Tax Court determining a deficiency in petitioner's income taxes for the taxable year ended September 30, 1944, and a deficiency in excess profits taxes for the taxable year ended September 30, 1945. Tietjens, *Judge*.

Affirmed.

Freidin & Littauer, New York City (Eugene Meacham, Fred R. Tansill and Seymour Sheriff, of Counsel) for the petitioner.

[fol. 245] H. Brian Holland, Assistant Attorney General (Ellis N. Slack, Lee A. Jackson, and I. Henry Kutz, Special Assistants to the Attorney General, of Counsel) for the respondent.

HARLAN, *Circuit Judge:*

We are asked to review a decision of the Tax Court determining a deficiency of $7,129.21 in petitioner's income tax for the taxable year ended September 30, 1944, and a deficiency of $466,557.19 in excess profits tax for the taxable year ended September 30, 1945. The taxpayer is a New York corporation engaged in the manufacture of vacuum cleaners and electronic devices. For tax purposes it used a fiscal year ending each September 30 and reported on an accrual basis. Each fiscal year referred to

in this opinion will be designated simply by the calendar year in which it ended.

In the two years in question § 23(s) of the Internal Revenue Code [26 U.S.C.A. § 23(s)] provided that in computing net income there should be allowed as a deduction (from gross income) the "net operating loss deduction" provided in § 122 (26 U.S.C.A. § 122). Section 122(a) defines "net operating loss" as "the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d)." We are not concerned here with any of the provisions of subsection (d) except that contained in (d)(6) which permits the deduction of taxes "imposed by Subchapter E of Chapter 2 [excess profits taxes] paid or accrued within the taxable year," subject to certain rules not presently relevant. If a taxpayer has a net operating loss for a given taxable year, § 122(b)(1) and [fol. 246] (2) and § 122(c)[1] provide that it may be ap-

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[1] "§ 122. Net operating loss deduction

* * *

(b) Amount of carry-back and carry-over.

(1) Net operating loss carry-back. If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

(2) Net operating loss carry-over. If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding

(Here follow 2 Photolithographs, side folios 222, 223-243)

plied, in accordance with prescribed specifications, as a deduction in computing net income for the two preceding taxable years (called a "carry-back") and for the two [fol. 247] succeeding taxable years (called a "carry-over"), the starting point being with the second preceding taxable year, and any excess being carried successively, until exhausted, into the subsequent years ending with the taxable year secondly succeeding the year in which the net operating loss occurred.

The taxpayer had net operating losses in each of the years 1946 and 1947, and the dispute we have before us

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taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the intervening taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss and without regard to any net operating loss carry-back. For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941 shall be reduced by the sum of the net income for each of the two preceding taxable years (computed for each such preceding taxable year with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and computed by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year).

(c) Amount of net operating loss deduction. The amount of the net operating loss deduction shall be the aggregate of the net operating less carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income computed without such deduction and without the credit provided in section 26(e)) * * * "

relates primarily to (a) the proper computation of such losses for each of those years, and (b) the application of such losses to the years 1944 and 1945, in each of which the taxpayer had substantial taxable net income.

We come first to the questions relating to the year 1945 in respect of which the Tax Court sustained the determination of the Commissioner that there was a deficiency in excess profits taxes of more than $460,000.

The Commissioner determined that in 1947 the taxpayer had a net operating loss of $786,383.25, which he allowed as a "carry-back" deduction to 1945. The taxpayer claimed additional "carry-backs" to 1945 aggregating $1,381,402.33 by reason of (a) the remittance to the Collector in 1947 of $300,008.87 in respect of excess profits taxes for the years 1943, 1944 and 1945 which, it is asserted, should have been added to the net operating loss for 1947; (b) the remittance to the Collector in 1947 of $55,949.04 interest on the foregoing amount and on some $12,000 of additional income taxes for 1943, which, it is claimed, should also have been added to the 1947 net operating loss; and (c) the failure to allow any portion of the net operating loss for 1946, claimed to be $1,025,444.12, as a "carry-back" to 1945. Each of these claims was denied by the Commissioner, who was sustained by the Tax Court. The taxpayer also contends that the Tax Court erred in failing to credit on the asserted excess profits tax deficiency for 1945 the sum of $108,437.36, which the taxpayer re-[fol. 248] mitted to the Commissioner in 1947 in respect of 1945 excess profits taxes (this amount being part of the $300,008.87 referred to above).

1. *1947 Principal Remittances*

These remittances aggregating $300,008.87 were made under the following circumstances:

Prior to 1947, a dispute arose between the taxpayer and the Collector as to the taxpayer's 1943 tax liability. On August 30, 1946, the Collector issued a statutory notice asserting income and excess profits tax deficiencies for 1943 in the amount of $7,757.49 and $194,992.51, respectively. The taxpayer objected to these deficiencies and took the matter to the Tax Court. Meanwhile, settlement

negotiations were opened. On September 19, 1947, the taxpayer's auditor, believing that a formula for settlement had been reached, recomputed the tax liability for 1943 and sent the Collector a check for $190,002.16, of which $154,473.30 represented additional taxes for 1943 computed in accordance with the supposed settlement formula, and $35,528.86 the interest on such sum from December 15, 1943. The Collector deposited this check on September 29, 1947 in his "Suspense Account."

Notwithstanding this transaction, settlement conferences continued down to October 30, 1947, when they were broken off, the Head of the Technical Staff of the New York Division advising the Division Counsel on November 6, 1947 that a satisfactory settlement had not been reached and that defense of the case should proceed. However, negotiations were evidently resumed, for on February 24, 1948 a settlement stipulation was filed settling, among other things, the asserted 1943 excess profits tax deficiency for the sum of $140,147.87, which was $1,470.26 less than the amount attributable to excess profits taxes ($141,618.13) in the taxpayer's remittance of September 29, 1947.

[fol. 249] On September 29, 1947, the taxpayer also forwarded to the Collector a check for $178,810.92 stated in the letter of transmittal to represent additional taxes of $49,953.38 for 1944, with interest in the amount of $8,492.07, and of $108,437.36 for 1945, with interest in the amount of $11,928.11. This remittance was predicated on a Revenue Agent's examination of the taxpayer's books for 1944 and 1945 (as well as 1946 and 1947), and a computation by the taxpayer's auditor applying in respect of excess profits taxes the same supposed settlement formula as underlay the taxpayer's remittance relating to 1943 excess profits taxes. Although no deficiency notice had been issued, and no settlement negotiations had been begun as to 1944 and 1945 taxes, the factors giving rise to the alleged excess profits tax deficiency for 1943 were deemed equally applicable to 1944 and 1945. The Collector also deposited this second remittance in his "Suspense Account."

The taxpayer charged on its books to earned surplus the principal amounts of these two remittances as tax payments, *viz:* $154,473.30 for 1943, $49,953.38 for 1944, and

$108,437.36 for 1945. Of the first item, $12,855.17 represented income taxes (with which we are not concerned here) and the balance, aggregating $300,008.87, represented excess profits taxes. The interest payments on these three items were charged to 1947 expense on the taxpayer's books, *viz:* $35,528.86 (1943), $8,492.07 (1944) and $11,928.11 (1945), or a total of $55,949.04.

The taxpayer's position that the $300,008.87 of remittances in respect of excess profits taxes should have been allowed as a deduction in computing the net operating loss for 1947 (thereby increasing the "carry-back" to 1945) rests upon §122(d)(6). As heretofore noted, this section gives a deduction for "the amount" of excess profits taxes "imposed" which were "paid or accrued within the taxable year."

[fol. 250] Preliminarily it should be said that while there is an issue relating to the computation of the 1946 net operating loss (which we discuss later) as to the correctness of the Tax Court's holding that in the case of an accrual taxpayer, as this taxpayer was, this section permits only the deduction of excess profits taxes which *accrued* within the taxable year, for the point now under discussion the taxpayer accepts the decision of the Tax Court in this respect as being correct. It can afford to do so since it is clear that none of these excess profits taxes had accrued prior to 1947 because they were in dispute—see *Dixie Pine Products Co.* v. *Comm'r*, 320 U. S. 516 (1944)—and whether they accrued in 1947 depends upon whether they can be considered as "paid" in that year despite the fact that the dispute over them was not settled until at least 1948. See *Chestnut Securities Co.* v. *United States*, 62 F. Supp. 574 (Ct. Cls. 1945), and *Lehigh Valley Railroad* v. *Comm'r*, 12 T. C. 977 (1949). So the sole question with which we are now concerned is whether these 1947 remittances constituted taxes "paid" within the taxable year, that is 1947, within the meaning of §122(d)(6). We think they did not.

A remittance made in respect of an asserted or putative tax liability in no proper sense constitutes a tax "payment" except to the extent that it is effective to discharge such liability in whole or in part. That in turn depends upon the agreement of the taxpayer and the Commissioner or his representatives, acting within their powers, or upon

whether the taxing authorities have a duty under the particular circumstances involved to accept the remittance as a payment of the tax in full or *pro tanto*.

Here there was admittedly no agreement in this respect between the taxpayer and the taxing authorities in 1947, and the only question is whether the Collector was, in the setting of these remittances, under a duty to accept them as "payments" *pro tanto* of the asserted or putative tax [fol. 251] liabilities against Lewyt. We think he had no such duty. The taxpayer's 1943 tax liability was still in dispute on September 29, 1947, when these remittances were made. Settlement negotiations continued into 1948, and no settlement was reached until February 1948. Meanwhile the taxpayer's proceedings in the Tax Court remained alive. With respect to 1944 and 1945 taxes, the Revenue Agent had commenced his examination of the taxpayer's 1944 and 1945 returns, and it was clear that the same issues giving rise to the Commissioner's deficiency notice of August 30, 1946 as regards 1943 taxes were also involved for 1944 and 1945. So far as the record discloses, deficiency notices for 1944 and 1945 were not issued until February 16, 1950; and, in any event, it is clear that the controversy as to those issues present in the 1943 dispute, which were also applicable to 1944 and 1945, was active until at least 1948.

In these circumstances, we think that the action of the Collector in placing these 1947 remittances in his "Suspense Account" to abide the event of the disposition of these disputes was quite proper. The taxpayer was not entitled to have these remittances treated as a satisfaction of its tax liabilities in whole or in part, and at the same time continue to contest such liabilities, or at best leave the Collector with an ambiguous situation on his hands.

Rosenman v. *United States*, 323 U. S. 658 (1945), while not reaching the precise point we have here, does support our view of the matter. In that case the Supreme Court held that the period of limitation on refund claims provided in §910, I. R. C., requiring such claims to be presented within three years "after the payment of such tax," commenced to run from the time the Commissioner assessed the tax rather than from an earlier time when the taxpayer had made a general payment on account of estimated estate taxes. Stating that "payment" of a tax as contemplated by

§910, I. R. C., "plainly presupposes challenged action by [fol. 252] the taxing officials" in response to which a remittance is made, the Court under the facts of that case held that no "tax payment" occurred until there had been an assessment followed by its satisfaction in part out of moneys already deposited with the Collector and in part by additional amounts paid by the taxpayer in response to such assessment, since it was only at that point that interest began to run against the Government on any amount in excess of that ultimately found due as the tax. While we do not read *Rosenman* to foreclose treating as a tax payment any remittance made prior to assessment, we do think that it supports the view that a remittance which does not *satisfy* an asserted tax liability should not be treated as the "payment" of a tax. Satisfaction may, as in *Rosenman*, follow from payment of a tax assessed, for such a payment extinguishes the asserted liability, even though the taxpayer is left with an independent claim for refund which survives the discharge of the assessment. Or it may follow from the payment of an asserted liability in advance of assessment, as appears to be contemplated by §56(d), I. R. C., and 26 C. F. R. 601.13(b)(2),[2] *if*, as is expressly provided in the latter and by necessary implication in the former, the payment is accompanied by the taxpayer's acquiescence in the proposed deficiency. The same holds true as to §271(a)(1)(B), requiring that amounts "collected without assessment" be excluded from the computation of a deficiency, for here again acquiescence by the taxpayer in such collections as constituting satisfaction of part of his tax liability is a condition necessarily to be implied. In short, there can be no payment without satisfaction whether pursuant to or apart from an assessment. Here the taxpayer was tendering its check with one hand, and [fol. 253] contesting its liability to pay with the other. Its Tax Court proceedings as to the 1943 deficiency still stood, and that avenue was still open to it as to 1944 and 1945 taxes.

The taxpayer is quite mistaken, we believe, in reading *Rosenman* as standing for the proposition that the 1947

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[2] See also informal ruling of Internal Revenue Bureau contained in Prentice-Hall Federal Tax Service, 1950, par. 76,331.

remittances should be treated as tax payments *ab initio* to the extent of the taxes ultimately found owing because they were effective to stop the running of interest against the taxpayer. The initial *Rosenman* payment was found not to be a tax payment despite the fact that the Court recognized that it stopped penalties and, as the Government conceded, interest *against the taxpayer*. It was found not to be a tax payment because it gave rise to no interest claim *against the Government*. The situation here is no different. Nor do we find such decisions as *Hanley* v. *United States*, 63 F. Supp. 73 (Ct. Cls. 1945), inconsistent with our conclusion, for there the taxpayer did not negative "payment" by simultaneous contest. Cf. *Murphy* v. *United States*, 78 F. Supp. 236 (S. D. Calif. 1948).

We hold that the 1947 remittances did not constitute "payment" of the taxpayer's 1943, 1944 and 1945 tax liabilities. They were no more than deposits "made in the nature of a cash bond for the payment of taxes thereafter found to be due." *Rosenman*, at p. 662.

The taxpayer also argues that the Tax Court's order entered on the 1948 stipulation settling the 1943 excess profits tax liability binds the Government by way of collateral estoppel from now asserting that the 1947 remittance in respect of the 1943 tax was not a payment of the tax. We need not dwell on this contention. It seems clear (although the pleadings are not before us) that the settlement was concerned only with the *fact* of payment and not with its *date*. The item in the stipulation "Tax paid: September 29, 1947 (3rd NY)" does not persuade us that the [fol. 254] question we now have before us was really at issue in the Tax Court.

2. *1947 Interest Payments*

For the same reasons the taxpayer's contention as to the deductibility of the 1947 interest payments in respect of 1943, 1944 and 1945 taxes must also fail.

3. *1946 Net Operating Loss*

The taxpayer challenges the determination of the Commissioner and the Tax Court as to the amount of the 1946 net operating loss.

As determined below, the net operating loss for 1946 was $164,326.38. The taxpayer argues that it should have been increased by $861,118.04, being the amount of the excess profits taxes which it paid in that year in respect of 1945.

This requires us to interpret the phrase "paid or accrued" in §122(d)(6) permitting the deduction of excess profits taxes "paid or accrued within the taxable year" in the computation of the net operating loss under §122(a). As already noted, it was unnecessary to reach this problem with respect to the 1947 net operating loss. The Tax Court held that "paid or accrued" meant that a *cash* taxpayer was entitled to deduct only excess profits taxes "paid," and an *accrual* taxpayer only those "accrued," within the taxable year, and that since Lewyt was an accrual taxpayer this sum of $861,118.04 could only be reckoned in Lewyt's tax computations for 1945. We think the Tax Court was right.

We start with the statute itself. Section 48(c), I. R. C., 26 U. S. C. A. §48, provides that "when used in this chapter" (that is Chapter 1 entitled "Income Tax") "the terms * * * 'paid or accrued' shall be construed *according to the method of accounting upon the basis of which the net in-*[fol. 255] *come is computed under this Part* [IV "Accounting Periods and Methods of Accounting"].[3] See also T. R. 29.43-1. Section 43, I. R. C., 26 U. S. C. A. §43, captioned "Period for which deductions and credits taken" states: "The deductions and credits * * * provided for in this chapter [1] shall be taken for the taxable year in which 'paid or accrued' * * * dependent upon the method of accounting upon the basis of which net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period."

The taxpayer makes a number of arguments to avoid what we think to be the plain effect of these provisions. We consider first its argument based on legislative history. Section 202(a) of the Revenue Act of 1941 amended §23(c) of the Internal Revenue Code to permit deduction of Chapter 2E excess profits taxes "paid or accrued within the taxable year" in computing net income, subject to certain

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[3] All italics in this opinion have been supplied.

rules provided in §23(c)(2), one of which, "A," stated: "The deduction shall be limited to the tax *imposed* for the taxable year, but any portion of such tax paid *after* the taxable year shall be considered as having been paid *within* the taxable year * * *" The taxpayer here points out, and we think correctly, that this last quoted provision in effect placed cash and accrual taxpayers substantially on an *accrual* basis so far as the excess profits tax deduction was concerned. Then came the Revenue Act of 1942 which by §105(c) eliminated Chapter 2E excess profits taxes as a deduction in computing net income, but added, by §105(c)(3)(C), a new Section, §122(d)(6), permitting the deduction of such excess profits taxes from gross income in computing the net operating loss, and net operating loss "carry-backs" and "carry-overs," subject to rules which were the same as those presently contained in §122(d)(6).

[fol. 256] Pointing out that these rules are substantially the same as those formerly contained in §23(c)(2) as amended by the Revenue Act of 1941, except that rule "A" of that section, quoted above, was omitted, the taxpayer argues that one of two inferences should be drawn—either that the Congressional intent was that the basis of deductibility of excess profits taxes should follow the taxpayer's method of accounting, *i.e.*, cash or accrual, or that in this respect the Act gave a taxpayer, whether cash or accrual, an election to deduct such taxes if either paid or accrued. It is urged that the latter inference is the more compelling, it being argued, as we shall see in a moment, that to draw the first inference would attribute to Congress an intention to "discriminate" between cash and accrual taxpayers, in that an accrual taxpayer, absent such an election, would rarely be able to take an excess profits deduction in a "loss" year.

We think that without more — the arguments for and against these opposing inferences would at best present a stand-off. But we need not pause to examine them further, for here we have the explicit direction of §43 that this deduction "shall be taken for the taxable year in which 'paid or accrued' * * * *dependent upon the method of accounting upon the basis of which net income is computed*, unless in order to reflect the income the deductions * * * should be taken as of a different period." Certainly the

exception would have no application in this instance, and it appears not to be contended to the contrary.

Next, we are referred to *Commissioner* v. *Clarion Oil Co.*, 148 F. 2d 671 (D. C. Cir.), *cert. denied* 325 U. S. 881 (1945), and a line of cases following it, *Birmingham* v. *Loetscher Co.*, 188 F. 2d 78 (8th Cir. 1951); *Aramo-Stiftung* v. *Comm'r*, 172 F. 2d 896 (2d Cir. 1949); and *Wm. J. Lemp Brewing Co.* v. *Comm'r*, 18 T. C. 586 (1952), holding that the provisions of former §356, I. R. C., now §505(a)(1), [fol. 257] I. R. C., 26 U. S. C. A. §505, permitting the deduction of excess profits taxes "paid or accrued during the taxable year" in computing the surtax upon the undistributed net income of personal holding companies under §500, I. R. C., 26 U. S. C. A. §500, gives a taxpayer, whether cash or accrual, the option of taking this deduction on either basis. The ground of these decisions, as exemplified by *Clarion*, is that the provisions of §48(c) in Chapter 1 of the Internal Revenue Code defining "paid or accrued" in terms of a taxpayer's method of reporting for the purpose of computing *net income* under that Chapter, have no application to the meaning of §505(a)(1) permitting deduction of excess profits taxes for the purpose of computing the *undistributed income* tax on personal holding companies under Chapter 2. "But, obviously, this definition [48(c)] was intended to apply to the method of computing *net income*, and has no reference or relevancy to the subject matter of what, for the purposes of the newly added provision in relation to personal holding companies is taxable as *undistributed* income." *Clarion*, at p. 675. Stated otherwise, Chapter 2 contains no provisions comparable to §48(c) and §43 of Chapter 1 defining the phrase "paid or accrued."

The *Clarion* and the other cases cited are inapplicable to the one before us. Here the meaning of "paid or accrued" in §122(d)(6) is directly involved in the computation of *net income*, for §23(s) allows as a deduction in "computing net income" under §23 "the net operating loss deduction computed under Section 122." In addition, to the extent that the meaning of "paid or accrued" is involved in the computation of the net operating loss itself by application of the §122(d)(6) deduction, §43 specifically gives

it the same meaning as §48(c) requires in connection with the computation of net income.

[fol. 258] The third contention which the taxpayer presses upon us is that to construe §122(d)(6) as we do discriminates against the accrual taxpayer. The argument is that in the nature of things it is usually impossible for a taxpayer to incur in the same year both an excess profits tax liability and a net operating loss. Therefore, it is said, an *accrual* taxpayer in most cases will be unable to get the benefit of the §122(d)(6) adjustment in calculating his net income, while a *cash* taxpayer normally will. Take this hypothetical situation as illustrative of the taxpayer's point. A corporation had high profit years in 1942 and 1943 and incurred a $1,000,000 excess profits tax liability in the latter year, which it paid in 1944. In 1944 it had a net operating loss of $500,000, without regard to any §122(d)(6) adjustment. If an *accrual* taxpayer, the corporation would not be able to add its excess profits taxes for 1943 to its net operating loss for 1944; if a *cash* taxpayer, it would; and this in turn would mean that the cash taxpayer's net operating loss "carry-back" to 1942 and 1943 under §122(b)(1) would be increased by $1,000,000, whereas the accrual taxpayer's "carry-back" would remain at $500,000.

We may conceive of situations where the accrual taxpayer is not put at this disadvantage with the cash taxpayer. One such is a situation where, as in the case of this taxpayer's 1943 excess profits taxes, accrual of the excess profits tax liability has been postponed because of a dispute concerning it, and the time of payment and accrual therefore coincide. See *Robert Reis & Co.* v. *Comm'r*, 20 T. C. 294 (1953). Nevertheless, we would not be candid if we failed to recognize the force of what the taxpayer argues here. But however sympathetic one may be to this predicament of an accrual taxpayer—a phenomenon by no means unique under the tax laws—we would not be justified in ignoring the plain mandate of the statute.

[fol. 259] Finally, on this point the taxpayer gives us the decision of the Court of Claims in *Olympic Radio and Television, Inc.* v. *United States*, 108 F. Supp. 109 (1952), *rehearing denied* 110 F. Supp. 600 (1953), which squarely upholds the position of the taxpayer as to the meaning of "paid or accrued" in §122(d)(6). We have given careful

and respectful consideration to the two opinions of the majority in that case, which were based largely on the same considerations urged upon us by the taxpayer here, and find ourselves unable to agree with the Court of Claims.

4. *1946 Net Operating Loss "Carry-Back"*

Now we came to the issue involving the "carry-back" of the 1946 net operating loss to 1944 and 1945. As previously noted, §122(b)(1) requires that such loss be applied first to the year 1944 and the excess, if any, to 1945. That excess is the amount by which the 1946 operating loss exceeds the income for 1944 "computed (A) with the exceptions, additions, and limitations provided in subsection (d)(1), (2), (4), and (6) [of §122] *and* (B) by determining the net operating loss *deduction* for such second preceding taxable year [1944] without regard to such [1946] net operating loss." §122(b)(1) and §122(c).

In terms of the present case, the situation in this: The taxpayer's 1944 income, as to which there is no dispute, was $584,866.81, *without regard* to any §122(d)(6) adjustment or the 1946 net operating loss deduction under §23(s). There was no net operating loss for 1944. The net operating loss for 1946, as determined by the Commissioner, was $164,326.38, and we have already disposed of the contention that it should have been increased by $861,118.04, the amount of the excess profits taxes paid by the taxpayer in 1946 in respect of 1945.

The taxpayer contends that in computing the amount of the 1946 net operating loss ($164,326.38) which is to be [fol. 260] carried back to 1945, there should first be offset against 1944 net income ($584,866.81) either (a) the sum of $759,916.50, being the amount of the 1943 excess profits taxes reflected in the taxpayer's return for that year and *paid* by it in 1944, or (b) the sum of $625,561.59, being the amount of the 1944 excess profits taxes as reflected in the taxpayer's return for 1944, and which it claims *accrued* in 1944. Since under (a) the 1943 excess profits taxes *paid* in 1944 ($759,916.50) exceeded by $175,049.69 the unadjusted net income for 1944 ($584,866.81) and under (b) the 1944 excess profits taxes *accrued* for that year ($625,561.59) exceeded by $40,694.78 such net income for 1944 ($584,866.81), the taxpayer claims that the entire 1946 net

operating loss ($164,326.38) constitutes a "carry-back" to 1945. We cannot agree.

What we have already held as to the meaning of "paid or accrued" in §122(d)(6) in connection with the computation of the 1946 net operating loss equally applies to the §122(d)(6) adjustment to 1944 net income, and disposes of the contention that for this purpose the taxpayer was entitled to deduct from such income the 1943 excess profits taxes *paid* in 1944.

The other contention must also fail. The excess profits taxes ultimately found by the Commissioner to be due in respect of the year 1944 were $280,540.33, and not $625,561.59, as originally reported in the taxpayer's 1944 return, and we think it was this figure rather than the uncorrected figure which represented the measure of the §122(d)(6) adjustment to 1944 net income. Section 122(d)(6) allows the deduction of "the amount" of excess profits taxes "imposed" and (in the case of an accrual taxpayer) "accrued within the taxable year." The tax which was "imposed" for 1944 was $280,540.33, and that in our opinion was "the amount" of the tax which "accrued" in 1944 for purposes [fol. 261] of this adjustment. True, it has been held that when all the events necessary to determine the amount of a tax have occurred within a taxable year, the tax as reported in that year constitutes the tax "accrued" despite the occurrence of later events which change the amount of the tax ultimately found due. See *United States* v. *Detroit-Moulding Corp.*, 56 F. Supp. 754 (E. D. Mich. 1944). But if we are to follow this view we should also take the *income* as originally reported in the 1944 return, *viz.*, $827,852.99 instead of $584,866.81 as finally determined by the Commissioner. What the taxpayer is seeking to do is to have the benefit of both the *smaller* 1944 income as finally determined ($584,866.81) and the *larger* excess profits tax ($625,561.59), based upon the income as originally reported. The taxpayer must match either the *returned* income ($827,852.99) against the *returned* excess profits tax based thereon ($625,561.59), or the *determined* income ($584,866.81) against the *determined* excess profits tax ($280,540.33). It cannot have it both ways at the same time by matching *determined* income against *returned* excess profits taxes.

And we think it is *determined* income and excess profits taxes that represent the proper §122(d)(6) adjustment, since the manifest purpose of the "carry-back" and "carry-over" provisions of the statute, §122(b)(1), (2) is that the incidence of this kind of taxation upon a business enterprise shall in effect be looked at from the vantage point of a five year period, that is the current taxable year plus two "carry-back" and two "carry-over" taxable years.

In light of this wearisome discussion, we think that the correct situation as to the 1946 "carry-back" was this: The taxpayer's 1944 net income, before the §122(d)(6) and §23(s) adjustments, was $584,866.81. The excess profits taxes which accrued for 1944 were $280,540.33. After the [fol. 262] §122(d)(6) adjustment ($584,866.81 *minus* $280,-540.33), the balance of 1944 income was $304,326.48. Since this was greater than the net operating loss for 1946 ($164,-326.38), this resulted, as the Commissioner and Tax Court determined, in there being nothing left from the 1946 net operating loss to "carry back" to 1945. It likewise resulted in there being taxable income for 1944.

5. Computation of 1945 Excess Profits Tax Deficiency

In computing the excess profits tax deficiency for 1945, the Commissioner apparently gave no credit for the $108,-437.36 remitted by the taxpayer on September 29, 1947. The taxpayer asserts this was an amount "collected without assessment" which under §271(a)(1)(B) the Commissioner was required to take into account in computing the 1945 deficiency. See *McConkey* v. *Comm'r*, 199 F. 2d 892 (4th Cir. 1952), *cert. denied* 345 U. S. 924 (1953); *Bendheim* v. *Comm'r*, 2d Cir., decided June 9, 1954.

For the reasons already discussed, we think that this would be so only if the remittance were made under circumstances which would constitute it a satisfaction of a tax liability in whole or in part. In the *McConkey* and *Bendheim* cases, *supra*, the taxpayers made remittances similar to that now under consideration. Each of those remittances was deposited in the Collector's "Suspense Account" and stood, under the authority of the *Rosenman* case, as "a cash bond for the payment of taxes thereafter found to be due," or, in effect, as a continuing offer by the

taxpayer to the Collector that he apply the amount to the discharge of a tax liability in whole or in part. And in each of those cases the Collector, after these deposits with their implicit offers had been made, stated a proposed deficiency not in excess of the deposit, thereby indicating unequivocally an acceptance of the taxpayer's offer. Accordingly, the amounts became "collected without assess-[fol. 263] ment" within the meaning of §271(a)(1)(B), and the taxpayer's sole remedy remaining was an independent suit for refund.

Here, however, the Collector did not accept, explicitly or implicitly, the taxpayer's remittance as a discharge of its tax liability, in whole or in part, nor could he be forced to do so while that liability was still in dispute. Indeed, no deficiency had yet been proposed in 1947. But in 1948 the Revenue Agent proposed a deficiency in excess of the taxpayer's remittance, as to which the Commissioner issued his deficiency notice on February 16, 1950, and which the taxpayer was free to, and did, contest; and certainly the Commissioner for his part was not required to circumscribe his position in the ensuing litigation in the Tax Court by making application of such remittance to the asserted tax liability. In other words, until the Commissioner, with unequivocal authority of the taxpayer, applied or was required to apply the $108,437.36 remittance as a satisfaction, in whole or in part, of the asserted tax liability, this remittance did not constitute an amount "collected without assessment" within the meaning of §271, but continued as no more than a deposit voluntarily made by the taxpayer.

Affirmed.

[fols. 264-285] UNITED STATES COURT OF APPEALS, SECOND CIRCUIT

Hon. Charles E. Clark, Hon. Carroll C. Hincks, Hon. John M. Harlan, Circuit Judges.

LEWYT CORP., (Now known as Lewyt Manufacturing Corporation), Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

JUDGMENT—July 14, 1954

Appeal from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

(S.) A. Daniel Fusaro, Clerk.

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[fol. 286] [Endorsed:] United States Court of Appeals, Second Circuit. Filed August 24, 1954. A. Daniel Fusaro, Clerk.

[fols. 287-288] UNITED STATES COURT OF APPEALS, SECOND CIRCUIT

Hon. Charles E. Clark, Hon. Carroll C. Hincks, Hon. John M. Harlan, Circuit Judges.

ORDER DENYING PETITION FOR REHEARING—August 24, 1954

A petition for a rehearing having been filed herein by counsel for the petitioner,

Upon consideration thereof, it is

Ordered that said petition be and hereby is denied.

(S.) A. Daniel Fusaro, Clerk.

[fol. 289] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 290] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1954

No. 417

LEWYT CORPORATION (now known as Lewyt Manufacturing Corporation), Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

ORDER ALLOWING CERTIORARI—Filed December 6, 1945

The petition for writ of certiorari to the United States Court of Appeals for the Second Circuit is granted limited to questions 1 and 2 presented by the application for the writ which read as follows:

"1. Whether, in the case of a taxpayer on the accrual basis, excess profits taxes paid within a taxable year constitute excess profits taxes 'paid or accrued within the taxable year' under § 122 (d) (6), 122(a) and § 122 (b) (1)

of the Internal Revenue Code of 1939 ('the Code') dealing with the computation of the net operating loss deduction.

2. Whether under § 122 (d) (6) and § 122 (b) (1) of the Code the 'tax imposed by Subchapter E of Chapter 2' [the excess profits tax] 'accrued within the taxable year' is the excess profits tax computed on the basis of the facts existing at the end of such taxable year or whether it is the excess profits tax ultimately determined to be due after application of a carry-back arising in a later year and after giving effect to other circumstances arising in later years."

The case is transferred to the summary calendar and assigned for argument immediately following No. 10.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

No. 417

IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

LEWYT CORPORATION (Now known as Lewyt Manufacturing Corporation), *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE *Respondent*.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No.

LEWYT CORPORATION (Now known as Lewyt Manufacturing Corporation), *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Lewyt Corporation (now known as Lewyt Manufacturing Corporation) prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this case on July 14, 1954.

OPINIONS BELOW

The opinion of the Tax Court of the United States, entered September 30, 1952, is reported in 18 T. C. 1245. The opinion of the Circuit Court of Appeals, printed in Appendix B hereto, *infra*, p. 29, has not yet been printed in the official reports.

JURISDICTION

The opinion and judgment of the Circuit Court of Appeals were entered on July 14, 1954. Appendix B, *infra*, p. 29 and Appendix C, *infra*, p. 48. A timely petition for rehearing, filed on July 28, 1954, was denied on August 24, 1954. The jurisdiction of this Court is invoked under 28 U. S. C. Section 1254 (1).

QUESTIONS PRESENTED

1. Whether, in the case of a taxpayer on the accrual basis, excess profits taxes paid within a taxable year constitute excess profits taxes "paid or accrued within the taxable year" under Section 122 (d)(6), Section 122 (a) and Section 122 (b)(1) of the Internal Revenue Code of 1939 ("the Code") dealing with the computation of the net operating loss deduction.

2. Whether under Section 122 (d)(6) and Section 122 (b)(1) of the Code the "tax imposed by Subchapter E of Chapter 2" [the excess profits tax] "accrued within the taxable year" is the excess profits tax computed on the basis of the facts existing at the end of such taxable year or whether it is the excess profits tax ultimately determined to be due after application of a carry-back arising in a later year and after giving effect to other circumstances arising in later years.

3. Whether under Section 122 (d)(6), Section 122 (a) and Section 23 (b) of the Code remittances designated by a taxpayer as "payments" of contested taxes and interest thereon constitute taxes and interest "paid" (and hence also "accrued") within the taxable year in which the remittances were made,[1] and, under Section 271 (a)(1)(B) of the Code, taxes "collected without assessment."

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[1] In connection with one of the remittances here involved, namely, the remittance of 1943 excess profits taxes, petitioner intends to urge, if certiorari is granted, that such remittance also constituted a "payment" of tax under the doctrine of collateral estoppel.

STATUTE INVOLVED

The applicable portions of the pertinent statute are set forth in Appendix A, *infra*, pp. 22-28.

STATEMENT

The facts, which are not in dispute, are briefly as follows:

Question 1. The taxpayer kept its books and accounts and filed its income and excess profits tax returns for the years here involved on the accrual basis, using a fiscal year ending each September 30.[2] In 1946 the taxpayer admittedly incurred a net operating loss, with the result that no excess profits taxes accrued in that year. However, in 1946 the taxpayer paid the amount of the excess profits tax liability ($861,118.04) accrued and shown on its return for 1945. The Tax Court sustained the Commissioner's determination that the amount of this payment did not constitute excess profits taxes "paid or accrued within the taxable year" under Section 122 (d)(6) and hence could not be added to the taxpayer's net operating loss for 1946. The Circuit Court of Appeals affirmed, ruling that under Section 122 (d)(6) an accrual basis taxpayer could not take account of excess profits taxes *paid* within said taxable year on its liability for a previous year. It is petitioner's contention that such tax payment should be included in its 1946 "net operating loss." (R. 39; Appendix B, *infra*, pp. 38-43.)

Question 2. This question relates to the amount of the taxpayer's 1946 net operating loss which may be carried back to 1945. By the terms of Section 122 (b)(1), as applied to this case, the 1946 net operating loss (the amount of which will be determined by the disposition of question 1) is a carry-back to 1945 only to the extent such loss exceeds the 1944 net income computed (A) with the adjust-

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[2] Each fiscal year referred to hereafter in this petition is designated simply by the calendar year in which it ended.

ment provided in Section 122 (d)(6) regarding excess profits taxes "paid or accrued within the taxable year" (1944), and (B) by determining the net operating loss deduction for 1944 without regard to the 1946 net operating loss. Unless the 1946 net operating loss exceeds the 1944 net income when computed with these adjustments, there is, of course, no carry-back to 1945.

There is no dispute that the taxpayer's 1944 net income, computed without regard to the 1946 net operating loss and with no adjustment under Section 122 (d)(6), was $584,866.81. The issue under question 2 therefore involves the correct amount of adjustment to 1944 income under Section 122 (d)(6) on account of excess profits taxes "paid or accrued within the taxable year." If petitioner should prevail under question 1, the amount of such adjustment will be $759,916.50, the amount of 1943 excess profits taxes *paid* in 1944, as to which there is no dispute (R. 39). If respondent should prevail under question 1, then the question will arise, as it did below, as to the amount of excess profits taxes accrued in 1944. (Appendix B, *infra*, pp. 43-45.)

Petitioner contends, as it did below, that the amount of excess profits tax accrued in 1944 was $625,561.59, that being the excess profits tax computed on petitioner's original excess profits tax return for such year on the basis of the facts existing at the end of such year (R.189). The Circuit Court of Appeals held, however, that the excess profits tax which accrued in 1944 was $280,540.33, the amount of excess profits tax finally determined to be due for 1944 *after* giving effect to a net operating loss carry-back from 1946 of $164,326.38 and other events arising after the close of the year 1944. (R. 16, 20.) Since the 1946 net operating loss found by the Court below ($164,326.38) did not exceed $304,326.48 [that amount being the 1944 net income *before* the 1946 net operating loss carry-back ($584,866.81) reduced by the Section 122 (d)(6) adjustment as computed by the Court below ($280,540.33)], the Court's opinion resulted in there being no net operating

loss carry-back from 1946 to 1945. (Appendix B, *infra*, pp. 44-45.)

Question 3. This issue involves the question of whether certain remittances made during 1947 of contested excess profits taxes for the years 1943, 1944 and 1945 and of interest on contested taxes for such years constituted "payments" of tax and interest. The Court below held that they did not on the ground that the remittances were made while petitioner was still contesting its liability.

A holding that these remittances did constitute payments would permit the addition to petitioner's net operating loss for 1947 of the amount of such remittances regardless of whether petitioner prevails with respect to question 1 for, as recognized by the Courts below, a contested tax liability, in the case of an accrual basis taxpayer, accrues in the year of payment or settlement, whichever is earlier. Therefore, one effect of the holding of the Court below that these remittances did not constitute payments was to preclude petitioner from adding the amount of these remittances to its 1947 net operating loss for carry-back purposes. (Appendix B, *infra*, pp. ~~38-43.~~ 32-38)

The holding on this point also led the Court below to conclude (Point 5 of its opinion, Appendix B, *infra*, p. 46) that the Commissioner had correctly determined petitioner's excess profits tax deficiency for 1945 under Section 271 (a)(1)(B) even though he had not given the petitioner credit against its excess profits tax liability for one of such remittances, namely, the remittance made in 1947 with respect to 1945 excess profits tax liability.

The facts pertinent to the question of whether these remittances constituted payments are briefly as follows: Prior to 1947 a dispute arose between the taxpayer and the Commissioner as to the taxpayer's 1943 tax liability. In 1946, the Commissioner issued a statutory notice asserting an excess profits tax deficiency for 1943 in the amount of $194,992.51. The taxpayer thereupon petitioned the Tax Court to redetermine such deficiency. Conferences were

held for the purpose of attempting to settle the matter without trial, and at the conclusion of a conference on September 26, 1947, petitioner's certified public accountant believed agreement had been reached between authorized representatives of the Government and petitioner as to a basis of settlement. Accordingly, he computed the amount of additional taxes due in accordance with the supposed settlement and, on September 29, 1947, the taxpayer remitted by check to the Collector of Internal Revenue $141,618.13 on account of additional 1943 excess profits tax liability, plus an additional amount as interest on contested 1943 taxes. The letter of transmittal stated that the remittance represented "payment for the additional tax as computed by us." (R. 39-40, 42, 142; Appendix B, *infra*, pp. 32-33.)

Further conferences were subsequently held and, in 1948, a settlement agreement was reached. The amount of 1943 excess profits tax liability computed under the settlement was $140,147.87, or $1,470.26 less than the amount estimated by the taxpayer's accountant to be due on the basis of such settlement when he thought it had been reached in September 1947. The settlement agreement was consummated by a stipulation entered into between the taxpayer and the Commissioner in the 1943 Tax Court case showing excess profits "tax paid" of $141,618.13, with the $1,470.26 designated as an "overpayment." The Tax Court in that case entered judgment reciting that there was an "overpayment" in excess profits tax for 1943 in that amount. (R. 40-41, 134-136; Appendix B, *infra*, p. 33.)

Since the disposition of the issue present in 1943 affected the tax liability for 1944 and 1945 as well, the taxpayer also made a remittance on September 29, 1947 with respect to its liability for excess profits taxes and interest on taxes for such years and in the transmittal letter referred to the remittance as "payment of additional taxes" for 1944 and 1945. At the time of this remittance an audit of the taxpayer's 1944 and 1945 returns was in

process but no deficiency notice had been issued. However, there was outstanding at such time an unpaid assessment with respect to 1944 excess profits taxes (R. 39, 89-90, 189, 203) in an amount in excess of the remittance ($49,953.38) made with respect to 1944 taxes. (R. 41, 144; Appendix B, *infra*, pp. 33-34.)

The Collector promptly presented the taxpayer's checks of September 29, 1947 for payment to the credit of the Treasurer of the United States (R. 143, 145), and the Collector on his own motion entered the amount of the remittances in his "Suspense Account" (R. 40-41; Appendix B, *infra*, pp. 33-34), a bookkeeping account maintained to reflect remittances received when no unpaid assessments are outstanding. The remittances were shown by the taxpayer on its books and on its 1947 income tax return as charges to earned surplus. (R. 42; Appendix B, *infra*, p. 34.)

REASONS FOR GRANTING THE WRIT

Question 1. A. The Circuit Court of Appeals' decision declining to permit an accrual basis taxpayer to make an adjustment under Section 122 (d)(6) for excess profits taxes actually paid in the taxable year is in direct conflict with the decision of the Court of Claims in *Olympic Radio and Television, Inc.* v. *United States*, 108 F. Supp. 109, 124 Ct. Cl. 33 (1952), rehearing denied 110 F. Supp. 600, 124 Ct. Cl. 33 (1953). The Court below frankly stated that the *Olympic* case "squarely upholds the position of the taxpayer as to the meaning of 'paid or accrued' in § 122 (d)(6)", but found itself "unable to agree with the Court of Claims." (Appendix B, *infra*, p. 43.)

Certiorari was granted by this Court in the *Olympic Radio* case (Docket No. 10, October Term, 1954) on October 14, 1954. The petition for certiorari of the United States therein assigned conflict with this case as a basis for grant of certiorari and stated that the question involved is of "recurrent importance in the administration of the tax

laws", the same issue being "presented in at least 35 (and probably more) other cases now pending before the Court of Claims, the district courts, the Tax Court, and the Treasury, involving a total of at least $27,000,000 in taxes, plus interest."

B. The result of the decision below will be to discriminate against accrual basis taxpayers in favor of cash basis taxpayers. Usually, a taxpayer cannot *incur* or *accrue* in the same year both an excess profits tax liability and a net operating loss because taxes based on income are not ordinarily accrued in a loss year. But a taxpayer necessarily must *pay* an excess profits tax in a year subsequent to the year in which such liability arises. Hence, a cash basis taxpayer will frequently make an excess profits tax payment in the year of a net operating loss. Thus, under the decision of the Court below, accrual basis taxpayers ordinarily cannot obtain relief under Section 122 (d)(6) whereas cash basis taxpayers ordinarily can. The Court below acknowledged that such may well be the result of its decision and stated that "we would not be candid if we failed to recognize the force of what the taxpayer argues here." (Appendix B, *infra*, p. 42.)

The Court stated, however, that it could not take account of these equities without "ignoring the plain mandate of the statute." (Appendix B, *infra*, p. 42.) The "plain mandate" which the Court felt constrained to follow was the definition in Section 48 (c) of the Code that "when used in this Chapter [Chapter 1, entitled "Income Tax"], the terms 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part." But the definition in Section 48 (c) hardly constitutes a mandate in this case. Other courts (including the Second Circuit itself) have construed another section of the Code containing language virtually identical with that of Section 122 (d)(6), in the manner contended for by petitioner here. *Commissioner* v. *Clarion Oil Co.*, 148 F. (2d) 671 (App. D. C.,

1945), *cert. den.* 325 U. S. 881 (1945); *Aramo-Stiftung* v. *Commissioner*, 172 F. (2d) 896 (C.C.A. 2d, 1949); *Birmingham* v. *Loetscher Co.*, 188 F. (2d) 78 (C.C.A. 8th, 1951); *William J. Lemp Brewing Co.*, 18 T. C. 586 (1952).[3]

These cases arose under the personal holding company provisions of the Code, Section 505 (a)(1) of which provides for an adjustment to net income for "excess profits taxes paid or accrued during the taxable year." The Court below sought to distinguish these cases by erroneously assuming that the definition contained in Section 48 (c) was inapplicable to the personal holding company cases which arose under Chapter 2, stating (Appendix B, *infra*, p. 41):

> "Chapter 2 contains no provisions comparable to § 48 (c) and § 43 of Chapter 1 defining the phrase 'paid or accrued.'"

In so stating, the Court below appears to have inadvertently overlooked Section 507 (a) of the Code, which provides that:

> "The terms used in this subchapter [subchapter A of Chapter 2 dealing with personal holding companies] shall have the same meaning as when used in Chapter 1."

The personal holding company line of cases held that the normal meaning of the term "paid or accrued", that is, *either* paid *or* accrued, will be applied when necessary to carry out the intent of the statute. Thus, on the basis of considerations very similar to those urged by the petitioner here—the avoidance of discrimination between cash and accrual basis taxpayers—the Court, in the leading case in this line of decisions, the *Clarion Oil* case, interpreted the statute as contended for by petitioner here without

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[3] To the same effect is *Stevens, Inc.* v. *Johnson*, 115 F. Supp. 310 (S.D. N.Y. 1953), arising under the parallel provision in Section 102(d)(1)(A).

ignoring any statutory mandate, the Court saying (at p. 676 of 148 F. (2d)):

> "* * * Nor did Congress intend that the taxpayer on an accrual basis who entered in his books an arbitrary amount as 'reserve for taxes,' should be in a better position than the taxpayer on a cash basis, * * *."

Similar reasoning would appear to require a holding that would not place a cash basis taxpayer in a better position than an accrual basis taxpayer under Section 122 (d)(6).

Since virtually identical statutory provisions and considerations of equity are involved in this case as were involved in the personal holding company cases, there is a conflict in principle between the decision below and the decisions in such cases, which should be resolved by this Court.

Question 2. This question bears on the determination of the amount of the 1946 net operating loss which may be carried back to 1945. This issue is closely related to that under question 1 and a disposition of both questions appears essential to clarify the meaning of Section 122 (d)(6). Having held on this point (as it did under question 1) that an accrual basis taxpayer could take into account under Section 122 (d)(6) only taxes "accrued" within the taxable year because of the "explicit direction" of the statute, the Court below thereupon paradoxically disregarded the accepted meaning of the word "accrued" in order to carry out what it regarded as the "manifest purpose" of the statute. (Appendix B, *infra*, p. 45.) Specifically, the Court below refused to follow the rule that in determining accruals within a taxable year events occurring thereafter may not be taken into account. *Lucas* v. *American Code Co., Inc.*, 280 U. S. 445 (1930); *Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281 (1944). That doctrine, of course, requires that, as contended for by petitioner below, the tax accrued within a taxable year (1944) be deemed to be the tax as reported during that year despite the

occurrence of later events which change the amount of tax ultimately found due [*Stanard-Tilton Milling Co.*, 3 T. C. 1026 (1944), acquiesced; *United States* v. *Detroit Moulding Corporation*, 56 F. Supp. 754 (E. D. Mich., 1944)], and not, as held by the Court below, the tax finally determined to be due after the occurrence in later years of net operating losses and other events.[4]

Indeed, the assumed statutory purpose by which the Court below justified disregarding the accepted meaning of the word "accrued" is a purpose specifically negatived by the very statutory language in issue. Thus, the Court below stated as its view that the determined income for the taxable year must be "matched" against the determined excess profits tax based thereon[5] (Appendix B, *infra*, p. 45)

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[4] The Court stated, at the outset of its discussion of this point, that the excess profits tax which was "imposed" for 1944 was $280,540.33 (Appendix B, *infra*, p. 44), that being the excess profits tax on the 1944 income *after* application of the 1946 net operating loss carry-back. Petitioner does not interpret the Court's opinion as relying on this point since later in summarizing its opinion the Court said: "The excess profits taxes which *accrued* for 1944 were $280,540.33." (Appendix B, *infra*, p. 45) However, to the extent that the Court gave any weight to its statement that the excess profits tax *imposed* for 1944 was $280,540.33 (the tax after carry-back), then a conflict in principle with *Manning* v. *Seeley Tube and Box Company*, 338 U. S. 561 (1950) would seem to exist, and would constitute a further ground for granting this petition. In the *Seeley Tube and Box* case it was held that under Sections 271(a) and 292 of the Code (dealing with the computation of interest) the term "tax imposed" means the tax originally due for a taxable year even though such tax liability is subsequently reduced or wiped out by carry-backs. See also Section 56(a) of the Code which requires a taxpayer to pay the "tax imposed by this chapter" on the fifteenth day of the third month following the close of the taxable year, at which time, of course, no carry-back from a subsequent year could have arisen.

[5] Actually, the result reached by the Court below is inconsistent with the theory advanced by it of matching income with the tax *based thereon*. The Court below matched determined income for 1944 *before* the net operating loss carry-back from 1946 ($5 4,866,81) with determined excess profits tax ($280,540.33) computed on the basis of the determined income *after* giving effect to such net operating loss carry-back ($420,540.43; R. 16-20).

if Section 122 (b)(1) and Section 122 (d)(6) are to be construed in accordance with what the Court below conceived to be the statutory purpose. But this could hardly have been the statutory purpose since the Code admittedly does not provide for such matching in the case of a cash basis taxpayer, where the excess profits tax "paid" for purposes of these sections is computed upon the income of another year and not upon the basis of the income for the year against which it is "matched."

The Court's opinion will make it mathematically impossible for any accrual basis taxpayer (in contrast to a cash basis taxpayer) ever to obtain any benefit from the (d)(6) adjustment under Section 122 (b)(1). Under question 1 the Court below felt compelled by the statutory language to reach a discriminatory result. Paradoxically, under question 2 the Court below deviated from the accepted meaning of the statutory language to reach such a result.

Question 3. A. Questions 1, 2, and 3, are so closely related that a disposition of all three questions is necessary to determine the meaning of Section 122(d)(6). All three questions involve the meaning of the words excess profits taxes "paid or accrued within the taxable year" as used in Section 122 (d)(6). Question 1 deals with the issue of whether an accrual basis taxpayer can take into account taxes "paid"; question 2 deals with the issue of when taxes "accrue"; and question 3 deals with the issue of when taxes are "paid."

B. The Court's decision on question 3 is in conflict with the decision of the Fourth Circuit Court of Appeals in *McConkey* v. *Commissioner*, 199 F. (2d) 892 (1952), *cert. den.* 345 U. S. 924 (1953), with the decision of another panel of judges[6] in the Second Circuit in *Bendheim* v. *Commis-*

[6] The instant case was decided by Judges Clark, Hincks and Harlan; the *Bendheim* case was decided by Judges Clark, Frank and Medina.

sioner, 214 F. (2d) 26 (June 9, 1954),[7] and with the decision of the Third Circuit Court of Appeals in *Standard Portland Cement Co.* v. *Commissioner*, 80 F. (2d) 585 (1935), in which cases remittances similar to those here involved were held to be "payments" or "collections without assessment."

These three cases involved the precise issue taken up in Point 5 of the opinion of the Court below, Appendix B, *infra*, p. 46, namely, whether a remittance constituted a "payment" or "collection without assessment" within the meaning of the definition of "deficiency" in Section 271 (a) of the Code. In the *Standard Portland Cement* case, and in the instant case with respect to the remittance made for 1945, the definition controlled the amount of "deficiency" finally determined by the Tax Court after hearing and deciding the substantive issues involved, the remittances in both cases having been made *after* the filing of a Tax Court petition. In the *McConkey* and *Bendheim* cases, where the remittances were made *prior* to the filing of a Tax Court petition, the definition controlled whether the Tax Court had jurisdiction, its jurisdiction obtaining only when there is a "deficiency" at the time the petition is filed.

The cited decisions are also in conflict with the holding of the Court below in Point 1 of its opinion (Appendix B, *infra*, p. 32) that the remittances of 1943, 1944 and 1945 excess profits taxes here in issue did not constitute payments of excess profits taxes for purposes of Section 122 (d)(6). (Appendix B, *infra*, p. 35.) The lower Court treated the issue under Point 5 as the same as that under Point 1 (p. 46, *infra*), since a "payment" for one purpose

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[7] In commenting on the opinion in the instant case, the Tax Barometer (July 24, 1954, par. 1251) stated: "The Second Circuit here reaches a conclusion contrary to that in the recent *Bendheim* case in a similar situation."

is a payment for all purposes under this Court's decision in *Rosenman* v. *United States*, 323 U. S. 658 (1945).[8]

The Court below recognized that the factor it relied on to hold the remittances in the instant case not to be payments—the continuance of the contest as to liability—was also present in the *McConkey* and *Bendheim* cases. However, it sought to distinguish those cases on the ground that after the remittances had been made in such cases "the Collector * * * stated a proposed deficiency [issued a 90-day letter] not in excess of the deposit, thereby indicating unequivocally an acceptance" of the taxpayers' "implicit" offers "to the Collector that he apply the amount to the discharge of a tax liability in whole or in part." (Appendix B, *infra*, p. 46.) But this distinction is untenable since the decisions in the *McConkey* and *Bendheim* cases were in no way based on the theory that issuance of the 90-day letters constituted acceptance of offers previously made. To the extent the 90-day letters had any relevance to the "implicit offers" of the taxpayers in the *McConkey* and *Bendheim* cases,[9] they constituted *rejections* and not *acceptances* thereof. As set forth by the Courts in the *McConkey* and *Bendheim* cases, the 90-day letters failed to reflect the remittances in the computation of the deficiencies there involved, the Commissioner having "overlooked" such remittances in each case, so that his issuance of the 90-day letters was "erroneous" and a "mistake." See 199 F. (2d) at 895 and 214 F. (2d) at 27 and 28. The opinions in both these cases make it plain that payments had been made as a matter of law at the time of the remittances and that

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[8] "It will not do to treat the same transaction as payment and not as payment, whichever favors the Government." 323 U. S. at 661.

[9] The theory of the Court below is based upon a misconception as to the manner in which the Commissioner of Internal Revenue exercises his collection functions. The 90-day letters in the *McConkey* and *Bendheim* cases were *not* issued by the Collector (as stated by the Court below) but on behalf of the Commissioner by the Internal Revenue Agent in Charge, an official without authority to accept remittances.

the payments did not *lose* their character as such by reason of the subsequent erroneous issuance of 90-day letters. Stated otherwise, the remittances in these cases were held to be payments not because the 90-day letters accepted them as such but in spite of the fact that the 90-day letters failed to treat them as such.

Finally, it is important to note that the Court below did not discuss at all the *Standard Portland Cement* case, *supra*, a decision as to which the "acceptance of offer" distinction made by the Court below could have no conceivable pertinence since the 90-day letter in that case, like the one here involved, had been dispatched before the remittance was made. The material facts of that case are identical with those here and the decision of the Court below is clearly in conflict with that decision.

C. The decision of the Court below is not only in conflict with the three decisions just discussed, but it is unsound in theory and inconsistent with principles accepted by the lower Court as a basis for its decision, as well as principles accepted by the Internal Revenue Service. Stating that a remittance of tax could not constitute a payment of tax unless it satisfied an asserted tax liability, the Court below went on to hold that satisfaction of an asserted liability in advance of assessment [10] did not occur when a remittance was made while a contest continued. That the accepted meaning of the term "payment" includes the payment of a contested tax liability is indicated by the familiar phrase "payment under protest." [11] The

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[10] Actually, as appears at p. 7, *supra*, and as pointed out by petitioner to the Court below, one of the remittances here involved, the remittance of 1944 excess profits taxes, was made when there was an unpaid assessment outstanding in excess of the remittance. Although the Court indicates that "satisfaction" of a liability in any event follows "from payment of a tax assessed", it failed to discuss this point in its opinion.

[11] "At common law and for many years under the federal statutes, *protest at the time of payment* was a condition precedent to the recovery of a tax." (Italics supplied), Cardozo, J. in *George Moore Ice Cream Co.* v. *Rose*, 289 U. S. 373 (1933).

novel suggestion by the Court that a remittance made when a taxpayer is contesting a liability cannot constitute a satisfaction of a liability or a payment is negatived by the very cases [*Chestnut Securities Co.* v. *United States* (Ct. Cl. 1945), 62 F. Supp. 574, and *Lehigh Valley Railroad*, 12 T. C. 977 (1949), acquiesced] which the Court relied upon (see Appendix B, *infra*, p. 34) as establishing the doctrine that accrual takes place no later than the year of "payment." For example, in the *Chestnut Securities* case, at p. 576, the Court said:

> "But if a liability is asserted against him and he pays it, *though under protest*, and though he promptly begins litigation to get the money back, the status of the liability is that it has been *discharged by payment*." (Italics supplied.)

Although the lower Court purports to find support for its view in a ruling of the Internal Revenue Service (Appendix B, *infra*, p. 37), the ruling cited by the Court (see Prentice-Hall Federal Tax Service (1950) Par. 76,331) specifically indicates that a remittance in advance of assessment may constitute a payment even though the taxpayer continues to contest his tax liability.

D. Since the making of voluntary payments before assessment is a practice commonly engaged in to stop the running of interest while a taxpayer contests his liability,[12] the decision of the Court below will affect and create confusion in a wide variety of important and recurring situations under many sections of the Internal Revenue Code in addition to those directly involved in this case.[13] As

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[12] American Law Institute (Goodrich and Redman), Procedure before the Bureau of Internal Revenue, 161-69.

[13] "Two of the most important current problems in the administration of our federal tax system center around the question when a tax is considered 'paid' or 'overpaid' for purposes of Section 322(b)(1) and for purposes of Section 3771(a) of the Internal Revenue Code." *Spear*, Tax Remittances in Advance of Filing Return or of Assessment, New York University Tenth Annual Institute on Federal Taxation 741 (1952).

earlier indicated, this Court has ruled (*Rosenman* v. *United States, supra*) that a tax payment for one purpose of the Internal Revenue Code is a tax payment for all purposes of the Code. One of the most important and frequently litigated situations involving the question of what constitutes a tax payment is whether a taxpayer is entitled to interest on a refund of an "overpayment" under Section 3771 (a) of the Code.[14] It has been the policy of the Internal Revenue Service to allow interest on certain "overpayments" made in advance of assessment despite the fact that the taxpayer is contesting his liability at the time he makes the remittance,[15] a practice which cannot be squared in principle with the decision of the Court below. If the decision below is allowed to stand, the continuance of this practice will be jeopardized and doubt will be cast on the propriety of past allowances of interest.

The opinion of the Court below will also cause uncertainty in a number of other situations which involve the question of whether a payment of tax has been made. Among such situations are the following: whether a claim for refund was filed within two years from the time the tax was paid, a period of limitation under Section 322 (b) (1) (*Rosenman, supra; Thomas* v. *Mercantile National Bank*, 204 F. (2d) 943 (C.C.A. 5, 1953)); [16] whether excess profits taxes have been paid within the taxable year for

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[14] The numerous cases on this point are collected in *Spear, supra*, note 13, and in *Alexander*, Overpayments of Taxes or Government Investment at Six Per Cent: The Problem of the Allowance of Interest, 7 Tax Law Review 231 (1952).

[15] Informal rulings published in Prentice-Hall Federal Tax Service (1950), Par. 76,331 and in Prentice-Hall Tax Ideas Service at Par. 8003.3 (page 8060).

[16] References in this paragraph are to the Internal Revenue Code of 1939. Similar problems arise under the Internal Revenue Code of 1954.

The cases cited in this paragraph are intended to illustrate some situations where a question can arise as to whether a "payment" occurred; it is not intended to imply that the material facts surrounding the remittances in such cases are identical to those here.

purposes of the adjustments under Section 122 (d) (6) (as in this case) and the parallel provisions in Section 505 (a) (1) (dealing with personal holding companies) and Section 102 (d) (1) (A) (dealing with unreasonable accumulation of surplus); whether, as in this case, interest on taxes has been paid within the taxable year for purposes of the deduction under Section 23 (b) of the Code; whether the taxes specified in Section 23 (c) are deductible as paid within the taxable year (*Lillian B. Glassell*, 12 T. C. 232 (1949), acquiesced; *Estate of Aaron Lowenstein*, 12 T. C. 694 (1949), acquiesced; I. T. 4054, 1951-2 C. B. 36); whether payments or "collections without assessment" have been made under Section 271 (a) (1) (B) for purposes of determining whether the Tax Court has jurisdiction (*McConkey* and *Bendheim, supra*) or of determining the proper amount of deficiency to be entered by the Tax Court (*Standard Portland Cement Co., supra; Henry T. Sloane Estate*, T. C. Memo. Op., Docket 108473, April 4, 1944); and whether the Tax Court may find an "overpayment" under Section 322 (d) (*Estate of Henry H. Rogers*, T. C. Memo. Op., Docket 100026, May 12, 1942; *Estate of Genevieve B. Macaulay*, 3 T. C. 350 (1944)).[17]

E. In attempting to determine when a payment of tax was made, lower courts voiced a wide variety of views so that in 1944 this Court granted *certiorari* in the *Rosenman* case, *supra*, to "resolve an asserted conflict of decisions in the lower courts." Since this Court decided the *Rosenman* case a renewed conflict of opinion has broken out in the federal courts, the latest manifestation of which is the conflict described above between this case and the *McConkey, Bendheim* and *Standard Portland Cement* cases, *supra*. The conflict in the "tax payment" cases has been

[17] See, also, *Roles* v. *Earle*, 195 F. (2d) 346 (C.C.A. 9, 1952), *cert. den.* 344 U. S. 819 (1952), involving the question whether the tax was *collected* by a collector of internal revenue who was no longer in office when suit was brought against the United States under former Section 1346 (a) (1) (ii) of 28 U.S.C.

the subject of much discussion in tax journals, where the cases are collected. *Spear*, Tax Remittances in Advance of Filing Return or of Assessment, New York University Tenth Annual Institute on Federal Taxation 741 (1952);[18] *Alexander*, Overpayments of Taxes or Government Investment at Six Per Cent; The Problem of the Allowance of Interest, 7 Tax Law Review 231 (1952);[19] *Salter*, Advance Remittances for Proposed Additional Taxes—Jurisdiction of the Tax Court and Related Problems, Taxes Magazine (CCH) June 1954, p. 478; *Irvins, Phillips and Barker*, How to Compute Interest on Refunds and Deficiencies, Prentice-Hall Tax Ideas Service, Par. 8003 at Par. 8003.3 (pp. 8057-8061). In part, the conflict appears to be attributable to a difference of view as to the effect of Section 4 (d) of the Current Tax Payment Act of 1943 (§ 3770 (c) of the Code), a provision of law which this Court stated need not be considered in the *Rosenman* case, presumably because the transactions there in issue occurred before the enactment of that statute. And, more fundamentally, there is a divergence of opinion as to the meaning of the *Rosenman* decision.

F. The Court below misconceived and misinterpreted the scope and intent of the opinion of this Court in the *Rosenman* case. While the Court below did not "read *Rosenman* to foreclose treating as a tax payment any remittance made prior to assessment",[20] (Appendix B, *infra*, p. 36) it thought that case "supported the view" that a remittance

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[18] "It appears that conflict in the decisions is not being clarified by the courts." *Spear*, at p. 775.

[19] "At present the courts are in a state of disagreement; to a large extent, the result of a case involving the allowance of interest may depend on the proper selection of the forum." *Alexander*, at p. 231.

[20] The view of the Court below that the *Rosenman* case did not attempt to lay down a general rule that a remittance made before assessment could not constitute a tax payment is not only borne out by the opinion in that case but is required by provisions of the Code which make it evident that a payment of tax may be due

must satisfy a liability in order to be treated as a payment, a test which the Court below concluded was not met here for the reasons discussed in sections B and C above. In suggesting that the *Rosenman* case had even this limited applicability, the Court below, petitioner submits, misconceived the rationale and scope of that decision. The *Rosenman* case involved an overpayment, as to which obvious difficulties arise in characterizing the remittance as a payment of *tax*. No such difficulties exist with respect to remittances necessary to meet the correct amount of tax liability, in which class fall virtually the entire amount of the remittances here involved.[21] The decisions of the Courts below make this case the only one, so far as petitioner is aware, in which a remittance designated as a payment of tax and necessary to meet the taxpayer's liability as ultimately determined has not been accepted at its face value as a payment.

This holding, petitioner submits, is entirely inconsistent with the basic rationale of the *Rosenman* opinion. While this Court in the *Rosenman* case held the overpayment there involved not to be a payment for purposes of starting the running of the statute of limitations, or of securing interest on refunds, it stated that the remittance of which the overpayment was a part was effective to stop the running of interest against the taxpayer on the amount eventually found owing, thereby indicating in effect that the remittance was a payment of tax when made to the extent

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and may be made in advance of assessment. Under Section 56 (a) the "tax imposed by this chapter" (that is, the tax liability as finally determined) is generally payable on March 15 even though assessment of a deficiency cannot occur until a later date. In any event, Section 56 (d) provides that "A tax imposed by this chapter * * * may be paid * * * prior to the date prescribed for its payment." Further, Section 271 (a)(1)(B) provides for the determination of a deficiency by crediting amounts "collected without assessment."

[21] All of the remittances here involved except $1,470.26 of the remittance of 1943 excess profits taxes (p. 6, *supra*) were necessary to meet the taxpayer's correct tax liability.

it was necessary to meet the taxpayer's finally determined tax liability. Since the Court at the same time made it clear that a payment for one purpose is a payment for all purposes, it is evident that the Court's holding is limited to *over*payments. It has no application to remittances, such as are here involved, of the correct amount of taxes. Of course, no problems of limitations or interest on refunds can arise in the case of such remittances.

CONCLUSION

This petition for a writ of certiorari should be granted.

Respectfully submitted,

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Counsel for Petitioner

October, 1954

APPENDIX A

Statute Involved

INTERNAL REVENUE CODE OF 1939:

"SEC. 21. NET INCOME.

"(a) DEFINITION.—'Net income' means the gross income computed under Section 22, less the deductions allowed by section 23.

* * * * * * * * * * *"

"SEC. 23. DEDUCTIONS FROM GROSS INCOME.

"In computing net income there shall be allowed as deductions:

* * * * * * * * * * *

"(b) INTEREST.—All interest paid or accrued within the taxable year on indebtedness, * * *

"(c) TAXES GENERALLY.—

"(1) ALLOWANCE IN GENERAL.—Taxes paid or accrued within the taxable year, except—

* * * * * * * * * * *

"(s) NET OPERATING LOSS DEDUCTION.—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * * * * * * * *"

"SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

"The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred,' dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *"

"SEC. 48. DEFINITIONS.

"When used in this chapter—

* * * * * * * * * * *

"(c) 'PAID OR INCURRED', 'PAID OR ACCRUED'.—The terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * * * * * * * * * *"

"SECTION 56. PAYMENT OF TAX.

"(a) TIME OF PAYMENT.—The total amount of tax imposed by this chapter shall be paid on the fifteenth day of March following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the third month following the close of the fiscal year."

(NOTE: This language was effective during the taxable years. Subsequent amendment by the 1950 Revenue Act does not change this language.)

* * * * * * * * * *

"(d) VOLUNTARY ADVANCE PAYMENT.—A tax imposed by this chapter or any installment thereof, may be paid, at the election of the taxpayer, prior to the date prescribed for its payment.

* * * * * * * * * * *"

"SEC. 102. SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS.

* * * * * * * * * *

"(d) DEFINITIONS.—As used in this chapter—

"(1) SECTION 102 NET INCOME.—The term 'section 102 net income' means the net income, computed without the benefit of the capital loss carry-over provided in section 117(e) from a taxable year which begins after December 31, 1940, and computed without the net operating loss deduction provided in section 23(s), minus the sum of—

"(A) TAXES.—Federal income, war-profits, and excess-profits taxes (other than the tax imposed by Subchapter E of Chapter 2 for a taxable year beginning after December 31, 1940), paid or accrued during the taxable year, to the extent not allowed as a deduction by section 23, but not including the tax imposed by this section or a corresponding section of a prior income-tax law.

* * * * * * * * * *"

"SEC. 122. NET OPERATING LOSS DEDUCTION.

"(a) DEFINITION OF NET OPERATING LOSS.—As used in this section, the term 'net operating loss' means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

"(b) AMOUNT OF CARRY-BACK AND CARRY-OVER.—

"(1) NET OPERATING LOSS CARRY-BACK.—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4) and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss."

(NOTE: This language was adopted by Section 153 of the 1942 Revenue Act, effective for the taxable years. Subsequent amendments by 1950 and 1951 Revenue Acts do not change the substance of the pertinent provisions.)

• • • • • • • • • • •

"(c) AMOUNT OF NET OPERATING LOSS DEDUCTION.—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d), (1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credits provided in section 26(h) and (i));

"(d) EXCEPTIONS, ADDITIONS, AND LIMITATIONS.—The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

"(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114(b), (2), (3), or (4);

"(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23(b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations;

"(3) No net operating loss deduction shall be allowed;

"(4) The amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includible on account of gains from such sales or exchanges. The deduction provided in section 23(ee) shall not be allowed.

"(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be computed with the exceptions and limitations specified in paragraphs (1) to (4) of this subsection. This paragraph shall not apply with respect to deductions allowable for losses sustained after December 31, 1950, in respect of property, if the losses arise from fire, storm, shipwreck, or other casualty, or from theft.

"(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

"(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or ex-

cess-profits taxes paid to any foreign country or possession of the United States;

"(B) Such tax shall be computed without regard to the adjustments provided in section 734; and

"(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

* * * * * * * * * * *"

(NOTE: Section 304(c) of the Excess Profit Tax Act of 1950 makes Code Sec. 122(d)(6) inapplicable with respect to any taxable year ending after June 30, 1950.)

"SEC. 271. DEFINITION OF DEFICIENCY.

"(a) IN GENERAL.—As used in this chapter in respect of a tax imposed by this chapter, 'deficiency' means the amount by which the tax imposed by this chapter exceeds the excess of—

"(1) The sum of (A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus (B) the amounts previously assessed (or collected without assessment) as a deficiency, over—

"(2) the amount of rebates, as defined in subsection (b)(2), made."

"SECTION 292. INTEREST ON DEFICIENCIES.

"(a) GENERAL RULE.—Interest upon the amount determined as a deficiency shall be assessed at the same time as the deficiency, shall be paid upon notice and demand from the collector, and shall be collected as a part of the tax, at the rate of 6 per centum per annum from the date prescribed for the payment of the tax (or, if the tax is paid in installments, from the date prescribed for the payment of the first installment) to the date the deficiency is assessed, or, in the case of a waiver under section 272(d), to the thirtieth day after the filing of such waiver or to the date the deficiency is assessed whichever is the earlier. If any

portion of the deficiency assessed is not to be collected by reason of a prior satisfaction, in whole or in part, of the tax, proper adjustment shall be made with respect to the interest on such portion."

"SEC. 322. REFUNDS AND CREDITS.

* * * * * * * * * *

"(b) LIMITATION ON ALLOWANCE.—

"(1) PERIOD OF LIMITATION.—Unless a claim for credit or refund is filed by the taxpayer within three years from the time the return was filed by the taxpayer or within two years from the time the tax was paid, no credit or refund shall be allowed or made after the expiration of whichever of such periods expires the later. If no return is filed by the taxpayer, then no credit or refund shall be allowed or made after two years from the time the tax was paid, unless before the expiration of such period a claim therefor is filed by the taxpayer."

"SEC. 505. SUBCHAPTER A NET INCOME.

"For the purposes of this subchapter the term 'Subchapter A Net Income' means the net income with the following adjustments:

"(a) ADDITIONAL DEDUCTIONS.—There shall be allowed as deductions.—

"(1) Federal income, war-profits, and excess-profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under section 23; but not including the tax imposed by section 102, section 500, or a section of a prior income-tax law corresponding to either of such sections.

* * * * * * * * * *"

"SEC. 507. MEANING OF TERMS USED.

"(a) GENERAL RULE.—The terms used in this subchapter shall have the same meaning as when used in chapter 1.

* * * * * * * * * *"

"SEC. 3770. AUTHORITY TO MAKE ABATEMENTS, CREDITS, AND REFUNDS.

"(c) RULE WHERE NO TAX LIABILITY.—An amount paid as tax shall not be considered not to constitute an overpay-

ment solely by reason of the fact that there was no tax liability in respect of which such amount was paid."

"SEC. 3771. INTEREST ON OVERPAYMENTS.

"(a) RATE.—Interest shall be allowed and paid upon any overpayment in respect of any internal revenue tax at the rate of 6 per centum per annum.

"(b) PERIOD.—Such interest shall be allowed and paid as follows:

"(1) CREDITS.—In the case of a credit, from the date of the overpayment to the due date of the amount against which the credit is taken, but if the amount against which the credit is taken is an additional assessment of a tax imposed by the Revenue Act of 1921, 42 Stat. 227, or any subsequent Revenue Act, then to the date of the assessment of that amount.

"(2) REFUNDS.—In the case of a refund, from the date of the overpayment to a date preceding the date of the refund check by not more than thirty days, such date to be determined by the Commissioner, whether or not such refund check is accepted by the taxpayer after tender of such check to the taxpayer. The acceptance of such check shall be without prejudice to any right of the taxpayer to claim any additional overpayment and interest thereon."

APPENDIX B

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 184—October Term, 1953.

Argued April 15, 1954 Decided July 14, 1954

Docket No. 22871

LEWYT CORPORATION (Now known as Lewyt Manufacturing Corporation), *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*

Before: CLARK, HINCKS and HARLAN, *Circuit Judges*

Petition to review a decision of the Tax Court determining a deficiency in petitioner's income taxes for the taxable year ended September 30, 1944, and a deficiency in excess profits taxes for the taxable year ended September 30, 1945. Tietjens, *Judge*. Affirmed.

FREIDIN & LITTAUER, New York City (Eugene Meacham, Fred R. Tansill and Seymour Sheriff, of Counsel) *for the petitioner.*

H. Brian Holland, Assistant Attorney General (Ellis N. Slack, Lee A. Jackson, and I. Henry Kutz, Special Assistants to the Attorney General, of Counsel) *for the respondent.*

HARLAN, *Circuit Judge*:

We are asked to review a decision of the Tax Court determining a deficiency of $7,129.21 in petitioner's income tax for the taxable year ended September 30, 1944, and

a deficiency of $466,557.19 in excess profits tax for the taxable year ended September 30, 1945. The taxpayer is a New York corporation engaged in the manufacture of vacuum cleaners and electronic devices. For tax purposes it used a fiscal year ending each September 30 and reported on an accrual basis. Each fiscal year referred to in this opinion will be designated simply by the calendar year in which it ended.

In the two years in question § 23(s) of the Internal Revenue Code [26 U. S. C. A. § 23(s)] provided that in computing net income there should be allowed as a deduction (from gross income) the "net operating loss deduction" provided in § 122 (26 U. S. C. A. § 122). Section 122(a) defines "net operating loss" as "the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d)." We are not concerned here with any of the provisions of subsection (d) except that contained in (d) (6) which permits the deduction of taxes "imposed by Subchapter E of Chapter 2 [excess profits taxes] paid or accrued within the taxable year," subject to certain rules not presently relevant. If a taxpayer has a net operating loss for a given taxable year, § 122(b)(1) and (2) and § 122(c) [1] provide that it may be applied, in

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[1] "§ 122. Net operating loss deduction

• • •

(b) Amount of carry-back and carry-over.

(1) Net operating loss carry-back. If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

(2) Net operating loss carry-over. If for any taxable year the taxpayer has a net operating loss, such net operating loss

accordance with prescribed specifications, as a deduction in computing net income for the two preceding taxable years (called a "carry-back") and for the two succeeding taxable years (called a "carry-over"), the starting point being with the second preceding taxable year, and any excess being carried successively, until exhausted, into the subsequent years ending with the taxable year secondly succeeding the year in which the net operating loss occurred.

The taxpayer had net operating losses in each of the years 1946 and 1947, and the dispute we have before us relates primarily to (a) the proper computation of such losses for each of those years, and (b) the application of such losses to the years 1944 and 1945, in each of which the taxpayer had substantial taxable net income.

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shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the intervening taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss and without regard to any net operating loss carry-back. For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941 shall be reduced by the sum of the net income for each of the two preceding taxable years (computed for each such preceding taxable year with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and computed by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year).

(c) Amount of net operating loss deduction. The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26(e)) • • •"

We come first to the questions relating to the year 1945 in respect of which the Tax Court sustained the determination of the Commissioner that there was a deficiency in excess profits taxes of more than $460,000.

The Commissioner determined that in 1947 the taxpayer had a net operating loss of $786,383.25, which he allowed as a "carry-back" deduction to 1945. The taxpayer claimed additional "carry-backs" to 1945 aggregating $1,381,402.33 by reason of (a) the remittance to the Collector in 1947 of $300,008.87 in respect of excess profits taxes for the years 1943, 1944, and 1945 which, it is asserted, should have been added to the net operating loss for 1947; (b) the remittance to the Collector in 1947 of $55,949.04 interest on the foregoing amount and on some $12,000 of additional income taxes for 1943, which, it is claimed, should also have been added to the 1947 net operating loss; and (c) the failure to allow any portion of the net operating loss for 1946, claimed to be $1,025,444.42, as a "carry-back" to 1945. Each of these claims was denied by the Commissioner, who was sustained by the Tax Court. The taxpayer also contends that the Tax Court erred in failing to credit on the asserted excess profits tax deficiency for 1945 the sum of $108,437.36, which the taxpayer remitted to the Commissioner in 1947 in respect of 1945 excess profits taxes (this amount being part of the $300,008.87 referred to above).

1. *1947 Principal Remittances*

These remittances aggregating $300,008.87 were made under the following circumstances:

Prior to 1947, a dispute arose between the taxpayer and the Collector as to the taxpayer's 1943 tax liability. On August 30, 1946, the Collector issued a statutory notice asserting income and excess profits tax deficiencies for 1943 in the amount of $7,757.49 and $194,992.51, respectively. The taxpayer objected to these deficiencies and

took the matter to the Tax Court. Meanwhile, settlement negotiations were opened. On September 29, 1947, the taxpayer's auditor, believing that a formula for settlement had been reached, recomputed the tax liability for 1943 and sent the Collector a check for $190,002.16, of which $154,473.30 represented additional taxes for 1943 computed in accordance with the supposed settlement formula, and $35,528.86 the interest on such sum from December 15, 1943. The Collector deposited this check on September 29, 1947 in his "Suspense Account."

Notwithstanding this transaction, settlement conferences continued down to October 30, 1947, when they were broken off, the Head of the Technical Staff of the New York Division advising the Division Counsel on November 6, 1947 that a satisfactory settlement had not been reached and that defense of the case should proceed. However, negotiations were evidently resumed, for on February 24, 1948 a settlement stipulation was filed settling, among other things, the asserted 1943 excess profits tax deficiency for the sum of $140,147.87 which was $1,470.26 less than the amount attributable to excess profit taxes ($141,618.13) in the taxpayer's remittance of September 29, 1947.

On September 29, 1947, the taxpayer also forwarded to the Collector a check for $178,810.92, stated in the letter of transmittal to represent additional taxes of $49,953.38 for 1944, with interest in the amount of $8,492.07, and of $108,437.36 for 1945, with interest in the amount of $11,928.11. This remittance was predicated on a Revenue Agent's examination of the taxpayer's books for 1944 and 1945 (as well as 1946 and 1947), and a computation by the taxpayer's auditor applying in respect of excess profits taxes the same supposed settlement formula as underlay the taxpayer's remittance relating to 1943 excess profits taxes. Although no deficiency notice had been issued, and no settlement negotiations had been begun as to 1944 and 1945 taxes, the factors giving rise to the alleged excess profits tax deficiency for 1943 were deemed equally ap-

plicable to 1944 and 1945. The Collector also deposited this second remittance in his "Suspense Account."

The taxpayer charged on its books to earned surplus the principal amounts of these two remittances as tax payments, *viz*: $154,473.30 for 1943, $49,953.38 for 1944, and $108,437.36 for 1945. Of the first item, $12,855.17 represented income taxes (with which we are not concerned here) and the balance, aggregating $300,008.87, represented excess profits taxes. The interest payments on these three items were charged to 1947 expense on the taxpayer's books *viz*: $35,528.86 (1943), $8,492.07 (1944) and $11,928.11 (1945), or a total of $55,949.04.

The taxpayer's position that the $300,008.87 of remittances in respect of excess profits taxes should have been allowed as a deduction in computing the net operating loss for 1947 (thereby increasing the "carry-back" to 1945) rests upon § 122(d)(6). As heretofore noted, this section gives a deduction for "the amount" of excess profits taxes "imposed" which were "paid or accrued within the taxable year."

Preliminarily it should be said that while there is an issue relating to the computation of the 1946 net operating loss (which we discuss later) as to the correctness of the Tax Court's holding that in the case of an accrual taxpayer, as this taxpayer was, this section permits only the deduction of excess profits taxes which *accrued* within the taxable year, for the point now under discussion the taxpayer accepts the decision of the Tax Court in this respect as being correct. It can afford to do so since it is clear that none of these excess profits taxes had accrued prior to 1947 because they were in dispute—see *Dixie Pine Products Co.* v. *Comm'r*, 320 U. S. 516 (1944)—and whether they accrued in 1947 depends upon whether they can be considered as "paid" in that year despite the fact that the dispute over them was not settled until at least 1948. See *Chestnut Securities Co.* v. *United States*, 62 F. Supp. 574 (Ct. Cls. 1945), and *Lehigh Valley Railroad* v. *Comm'r*,

12 T. C. 977 (1949). So the sole question with which we are now concerned is whether these 1947 remittances constituted taxes "paid" within the taxable year, that is 1947, within the meaning of § 122(d)(6). We think they did not.

A remittance made in respect of an asserted or putative tax liability in no proper sense constitutes a tax "payment" except to the extent that it is effective to discharge such liability in whole or in part. That in turn depends upon the agreement of the taxpayer and the Commissioner or his representatives, acting within their powers, or upon whether the taxing authorities have a duty under the particular circumstances involved to accept the remittance as a payment of the tax in full or *pro tanto.*

Here there was admittedly no agreement in this respect between the taxpayer and the taxing authorities in 1947, and the only question is whether the Collector was, in the setting of these remittances, under a duty to accept them as "payments" *pro tanto* of the asserted or putative tax liabilities against Lewyt. We think he had no such duty. The taxpayer's 1943 tax liability was still in dispute on September 29, 1947, when these remittances were made. Settlement negotiations continued into 1948, and no settlement was reached until February 1948. Meanwhile the taxpayer's proceedings in the Tax Court remained alive. With respect to 1944 and 1945 taxes, the Revenue Agent had commenced his examination of the taxpayer's 1944 and 1945 returns, and it was clear that the same issues giving rise to the Commissioner's deficiency notice of August 30, 1946 as regards 1943 taxes were also involved for 1944 and 1945. So far as the record discloses, deficiency notices for 1944 and 1945 were not issued until February 16, 1950; and, in any event, it is clear that the controversy as to those issues present in the 1943 dispute, which were also applicable to 1944 and 1945, was active until at least 1948.

In these circumstances, we think that the action of the Collector in placing these 1947 remittances in his "Sus-

pense Account" to abide the event of the disposition of these disputes was quite proper. The taxpayer was not entitled to have these remittances treated as a satisfaction of its tax liabilities in whole or in part, and at the same time continue to contest such liabilities, or at best leave the Collector with an ambiguous situation on his hands.

Rosenman v. *United States*, 323 U. S. 658 (1945), while not reaching the precise point we have here, does support our view of the matter. In that case the Supreme Court held that the period of limitation on refund claims provided in § 910, I. R. C., requiring such claims to be presented within three years "after the payment of such tax," commenced to run from the time the Commissioner assessed the tax rather than from an earlier time when the taxpayer had made a general payment on account of estimated estate taxes. Stating that "payment" of a tax as contemplated by § 910, I. R. C., "plainly presupposes challenged action by the taxing officials" in response to which a remittance is made, the Court under the facts of that case held that no "tax payment" occurred until there had been an assessment followed by its satisfaction in part out of moneys already deposited with the Collector and in part by additional amounts paid by the taxpayer in response to such assessment, since it was only at that point that interest began to run against the Government on any amount in excess of that ultimately found due as the tax. While we do not read *Rosenman* to foreclose treating as a tax payment any remittance made prior to assessment, we do think that it supports the view that a remittance which does not *satisfy* an asserted tax liability should not be treated as the "payment" of a tax. Satisfaction may, as in *Rosenman*, follow from payment of a tax assessed, for such a payment extinguishes the asserted liability, even though the taxpayer is left with an independent claim for refund which survives the discharge of the assessment. Or it may follow from the payment of an asserted liability in advance of assessment, as appears to be contemplated by

§ 56(d), I. R. C., and 26 C. F. R. 601.13(b)(2),[2] *if*, as is expressly provided in the latter and by necessary implication in the former, the payment is accompanied by the taxpayer's acquiescence in the proposed deficiency. The same holds true as to § 271(a)(1)(B), requiring that amounts "collected without assessment" be excluded from the computation of a deficiency, for here again acquiescence by the taxpayer in such collections as constituting satisfaction of part of his tax liability is a condition necessarily to be implied. In short, there can be no payment without satisfaction whether pursuant to or apart from an assessment. Here the taxpayer was tendering its check with one hand, and contesting its liability to pay with the other. Its Tax Court proceedings as to the 1943 deficiency still stood, and that avenue was still open to it as to 1944 and 1945 taxes.

The taxpayer is quite mistaken, we believe, in reading *Rosenman* as standing for the proposition that the 1947 remittances should be treated as tax payments *ab initio* to the extent of the taxes ultimately found owing because they were effective to stop the running of interest against the taxpayer. The initial *Rosenman* payment was found not to be a tax payment despite the fact that the Court recognized that it stopped penalties and, as the Government conceded, interest *against the taxpayer*. It was found not to be a tax payment because it gave rise to no interest claim *against the Government*. The situation here is no different. Nor do we find such decisions as *Hanley* v. *United States*, 63 F. Supp. 73 (Ct. Cls. 1945), inconsistent with our conclusion, for there the taxpayer did not negative "payment" by simultaneous contest. Cf. *Murphy* v. *United States*, 78 F. Supp. 236 (S. D. Calif. 1948).

We hold that the 1947 remittances did not constitute "payment" of the taxpayer's 1943, 1944 and 1945 tax liabilities. They were no more than deposits "made in the nature

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[2] See also informal ruling of Internal Revenue Bureau contained in Prentice-Hall Federal Tax Service, 1950, par. 76,331.

of a cash bond for the payment of taxes thereafter found to be due." *Rosenman*, at p. 662.

The taxpayer also argues that the Tax Court's order entered on the 1948 stipulation settling the 1943 excess profits tax liability binds the Government by way of collateral estoppel from now asserting that the 1947 remittance in respect of the 1943 tax was not a payment of the tax. We need not dwell on this contention. It seems clear (although the pleadings are not before us) that the settlement was concerned only with the *fact* of payment and not with its *date*. The item in the stipulation "Tax paid: September 29, 1947 (3rd NY)" does not persuade us that the question we now have before us was really at issue in the Tax Court.

2. *1947 Interest Payments*

For the same reasons the taxpayer's contention as to the deductibility of the 1947 interest payments in respect of 1943, 1944 and 1945 taxes must also fail.

3. *1946 Net Operating Loss*

The taxpayer challenges the determination of the Commissioner and the Tax Court as to the amount of the 1946 net operating loss.

As determined below, the net operating loss for 1946 was $164,326.38. The taxpayer argues that it should have been increased by $861,118.04, being the amount of the excess profits taxes which it paid in that year in respect of 1945.

This requires us to interpret the phrase "paid or accrued" in § 122(d)(6) permitting the deduction of excess profits taxes "paid or accrued within the taxable year" in the computation of the net operating loss under § 122(*a*). As already noted, it was unnecessary to reach this problem with respect to the 1947 net operating loss. The Tax Court held that "paid or accrued" meant that a *cash* taxpayer was entitled to deduct only excess profits taxes "paid,"

and an *accrual* taxpayer only those "accrued," within the taxable year, and that since Lewyt was an accrual taxpayer this sum of $861,118.04 could only be reckoned in Lewyt's tax computations for 1945. We think the Tax Court was right.

We start with the statute itself. Section 48(e), I. R. C., 26 U. S. C. A. § 48, provides that "when used in this chapter" (that is Chapter 1 entitled "Income Tax") "the terms * * * 'paid or accrued' shall be construed *according to the method of accounting upon the basis of which the net income is computed under this Part* [IV "Accounting Periods and Methods of Accounting"].[3] See also T. R. 29.43-1. Section 43, I. R. C., 26 U. S. C. A. § 43, captioned "Period for which deductions and credits taken," states: "The deductions and credits * * * provided for in this chapter [1] shall be taken for the taxable year in which 'paid or accrued' * * * dependent upon the method of accounting upon the basis of which net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period."

The taxpayer makes a number of arguments to avoid what we think to be the plain effect of these provisions. We consider first its argument based on legislative history. Section 202(a) of the Revenue Act of 1941 amended § 23(c) of the Internal Revenue Code to permit deduction of Chapter 2E excess profits taxes "paid or accrued within the taxable year" in computing net income, subject to certain rules provided in § 23(c)(2), one of which, "A," stated: "The deduction shall be limited to the tax *imposed* for the taxable year, but any portion of such tax paid *after* the taxable year shall be considered as having been paid *within* the taxable year * * *" The taxpayer here points out, and we think correctly, that this last quoted provision in effect placed cash and accrual taxpayers substantially on an *accrual* basis so far as the excess profits tax deduction was concerned. Then came the Revenue Act of 1942 which by

[3] All italics in this opinion have been supplied.

§ 105(c) eliminated Chapter 2E excess profits taxes as a deduction in computing net income, but added, by § 105 (e)(3)(C), a new Section, § 122(d)(6), permitting the deduction of such excess profits taxes from gross income in computing the net operating loss, and net operating loss "carry-backs" and "carry-overs," subject to rules which were the same as those presently contained in § 122(d)(6).

Pointing out that these rules are substantially the same as those formerly contained in § 23(c)(2) as amended by the Revenue Act of 1941, except that rule "A" of that section, quoted above, was omitted, the taxpayer argues that one of two inferences should be drawn—either that the Congressional intent was that the basis of deductibility of excess profits taxes should follow the taxpayer's method of accounting, *i.e.*, cash or accrual, or that in this respect the Act gave a taxpayer, whether cash or accrual, an election to deduct such taxes if either paid or accrued. It is urged that the latter inference is the more compelling, it being argued, as we shall see in a moment, that to draw the first inference would attribute to Congress an intention to "discriminate" between cash and accrual taxpayers, in that an accrual taxpayer, absent such an election, would rarely be able to take an excess profits deduction in a "loss" year.

We think that without more the arguments for and against these opposing inferences would at best present a stand-off. But we need not pause to examine them further, for here we have the explicit direction of § 43 that this deduction "shall be taken for the taxable year in which 'paid or accrued' * * * *dependent upon the method of accounting upon the basis of which net income is computed*, unless in order to reflect the income the deductions * * * should be taken as of a different period." Certainly the exception would have no application in this instance, and it appears not to be contended to the contrary.

Next, we are referred to *Commissioner* v. *Clarion Oil Co.*, 148 F. 2d 671 (D. C. Cir.), *cert. denied* 325 U. S. 881 (1945),

nd a line of cases following it, *Birmingham* v. *Loetscher* 'o., 188 F.2d 78 (8th Cir. 1951); *Aramo-Stiftung* v. *Comm'r*, 72 F. 2d 896 (2d Cir. 1949); and *Wm. J. Lemp Brewing* 'o. v. *Comm'r*, 18 T. C. 586 (1952), holding that the provisions of former § 356, I. R. C., now § 505(a)(1), I. R. C., 6 U. S. C. A. § 505, permitting the deduction of excess rofits taxes "paid or accrued during the taxable year" in omputing the surtax upon the undistributed net income f personal holding companies under § 500, I. R. C., 26 '. S. C. A. § 500, gives a taxpayer, whether cash or accrual, the option of taking this deduction on either basis. 'he ground of these decisions, as exemplified by *Clarion*, that the provisions of § 48(c) in Chapter 1 of the Internal Revenue Code defining "paid or accrued" in terms f a taxpayer's method of reporting for the purpose of omputing *net income* under that Chapter, have no application to the meaning of § 505(a)(1) permitting deduction f excess profits taxes for the purpose of computing the *ndistributed income* tax on personal holding companies nder Chapter 2. "But, obviously, this definition [48(c)] as intended to apply to the method of computing *net income*, and has no reference or relevancy to the subject natter of what, for the purposes of the newly added provision in relation to personal holding companies is taxable s *undistributed* income." Clarion, at p. 675. Stated otherise, Chapter 2 contains no provisions comparable to § 48(c) nd § 43 of Chapter 1 defining the phrase "paid or accrued."

The *Clarion* and the other cases cited are inapplicable to ne one before us. Here the meaning of "paid or accrued" § 122(d)(6) is directly involved in the computation of *t income*, for §23(s) allows as a deduction in "computing et income" under § 23 "the net operating loss deduction omputed under Section 122." In addition, to the extent hat the meaning of "paid or accrued" is involved in the omputation of the net operating loss itself by application f the § 122(d)(6) deduction, § 43 specifically gives it the ame meaning as § 48(c) requires in connection with the omputation of net income.

The third contention which the taxpayer presses upon us is that to construe § 122(d)(6) as we do discriminates against the accrual taxpayer. The argument is that in the nature of things it is usually impossible for a taxpayer to incur in the same year both an excess profits tax liability and a net operating loss. Therefore, it is said, an *accrual* taxpayer in most cases will be unable to get the benefit of the § 122(d)(6) adjustment in calculating his net income, while a *cash* taxpayer normally will. Take this hypothetical situation as illustrative of the taxpayer's point. A corporation had high profit years in 1942 and 1943 and incurred a $1,000,000 excess profits tax liability in the latter year, which it paid in 1944. In 1944 it had a net operating loss of $500,000, without regard to any § 122(d)(6) adjustment. If an *accrual* taxpayer, the corporation would not be able to add its excess profits taxes for 1943 to its net operating loss for 1944; if a *cash* taxpayer it would; and this in turn would mean that the cash taxpayer's net operating loss "carry-back" to 1942 and 1943 under § 122(b)(1) would be increased by $1,000,000, whereas the accrual taxpayer's "carry-back" would remain at $500,000.

We may conceive of situations where the accrual taxpayer is not put at this disadvantage with the cash taxpayer. One such is a situation where, as in the case of this taxpayer's 1943 excess profits taxes, accrual of the excess profits tax liability has been postponed because of a dispute concerning it, and the time of payment and accrual therefore coincide. See *Robert Reis & Co.* v. *Comm'r*, 20 T. C. 294 (1953). Nevertheless, we would not be candid if we failed to recognize the force of what the taxpayer argues here. But however sympathetic one may be to this predicament of an accrual taxpayer—a phenomenon by no means unique under the tax laws—we would not be justified in ignoring the plain mandate of the statute.

Finally, on this point the taxpayer gives us the decision of the Court of Claims in *Olympic Radio and Television, Inc.* v. *United States*, 108 F. Supp. 109 (1952), *re-hearing*

denied 110 F. Supp. 600 (1953), which squarely upholds the position of the taxpayer as to the meaning of "paid or accrued" in § 122(d)(6). We have given careful and respectful consideration to the two opinions of the majority in that case, which were based largely on the same considerations urged upon us by the taxpayer here, and find ourselves unable to agree with the Court of Claims.

4. *1946 Net Operating Loss "Carry-Back"*

Now we come to the issue involving the "carry-back" of the 1946 net operating loss to 1944 and 1945. As previously noted, § 122(b)(1) requires that such loss be applied first to the year 1944 and the excess, if any, to 1945. That excess is the amount by which the 1946 operating loss exceeds the income for 1944 "computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6) [of § 122] *and* (B) by determining the net operating loss *deduction* for such second preceding taxable year [1944] without regard to such [1946] net operating loss." § 122(b) (1) and § 122(c).

In terms of the present case, the situation is this: The taxpayer's 1944 income, as to which there is no dispute, was $584,866.81, *without regard* to any § 122(d) (6) adjustment or the 1946 net operating loss deduction under § 23(s). There was no net operating loss for 1944. The net operating loss for 1946, as determined by the Commissioner, was $164,326.38, and we have already disposed of the contention that it should have been increased by $861,118.04, the amount of the excess profits taxes paid by the taxpayer in 1946 in respect of 1945.

The taxpayer contends that in computing the amount of the 1946 net operating loss ($164,326.38) which is to be carried back to 1945, there should first be offset against 1944 net income ($584,866.81) either (a) the sum of $759,916.50, being the amount of the 1943 excess profits taxes reflected in the taxpayer's return for that year and *paid*

by it in 1944, or (b) the sum of $625,561.59, being the amount of the 1944 excess profits taxes as reflected in the taxpayer's return for 1944 and which it claims *accrued* in 1944. Since under (a) the 1943 excess profits taxes *paid* in 1944 ($759,916.50) exceeded by $175,049.69 the unadjusted net income for 1944 ($584,866.81) and under (b) the 1944 excess profits taxes *accrued* for that year ($625,561.59) exceeded by $40,694.78 such net income for 1944 ($584,866.81), the taxpayer claims that the entire 1946 net operating loss ($164,326.38) constitutes a "carry-back" to 1945. We cannot agree.

What we have already held as to the meaning of "paid or accrued" in § 122(d) (6) in connection with the computation of the 1946 net operating loss equally applies to the § 122(d) (6) adjustment to 1944 net income, and disposes of the contention that for this purpose the taxpayer was entitled to deduct from such income the 1943 excess profits taxes *paid* in 1944.

The other contention must also fail. The excess profits taxes ultimately found by the Commissioner to be due in respect of the year 1944 were $280,540.33, and not $625,561.59, as originally reported in the taxpayer's 1944 return, and we think it was this figure rather than the uncorrected figure which represented the measure of the § 122(d) (6) adjustment to 1944 net income. Section 122(d) (6) allows the deduction of "the amount" of excess profits taxes "imposed" and (in the case of an accrual taxpayer) "accrued within the taxable year." The tax which was "imposed" for 1944 was $280,540.33, and that in our opinion was "the amount" of the tax which "accrued" in 1944 for purposes of this adjustment. True, it has been held that when all the events necessary to determine the amount of a tax have occurred within a taxable year, the tax as reported in that year constitutes the tax "accrued" despite the occurrence of later events which change the amount of the tax ultimately found due. See *United States* v. *Detroit-Moulding Corp.*, 56 F. Supp. 754 (E. D. Mich.

1944). But if we are to follow this view we should also take the *income* as originally reported in the 1944 return, *viz.*, $827,852.99 instead of $584,866.81 as finally determined by the Commissioner. What the taxpayer is seeking to do is to have the benefit of both the *smaller* 1944 income as finally determined ($584,866.81) and the *larger* excess profits tax ($625,561.59), based upon the income as originally reported. The taxpayer must match either the *returned* income ($827,852.99) against the *returned* excess profits tax based thereon ($625,561.59), or the *determined* income ($584,866.81) against the *determined* excess profits tax ($280,540.33). It cannot have it both ways at the same time by matching *determined* income against *returned* excess profits taxes. And we think it is *determined* income and excess profits taxes that represent the proper § 122 (d) (6) adjustment, since the manifest purpose of the "carry-back" and "carry-over" provisions of the statute, § 122(b) (1), (2) is that the incidence of this kind of taxation upon a business enterprise shall in effect be looked at from the vantage point of a five year period, that is the current taxable year plus two "carry-back" and two "carry-over" taxable years.

In light of this wearisome discussion, we think that the correct situation as to the 1946 "carry-back" was this: The taxpayer's 1944 net income, before the § 122(d) (6) and § 23(s) adjustments, was $584,866.81. The excess profits taxes which accrued for 1944 were $280,540.33. After the § 122(d) (6) adjustment ($584,866.81 *minus* $280,540.33), the balance of 1944 income was $304,326.48. Since this was greater than the net operating loss for 1946 ($164,326.38), this resulted, as the Commissioner and Tax Court determined, in there being nothing left from the 1946 net operating loss to "carry back" to 1945. It likewise resulted in there being taxable income for 1944.

5. Computation of 1945 Excess Profits Tax Deficiency

In computing the excess profits tax deficiency for 1945, the Commissioner apparently gave no credit for the $108,437.36 remitted by the taxpayer on September 29, 1947. The taxpayer asserts this was an amount "collected without assessment" which under § 271(a)(1)(B) the Commissioner was required to take into account in computing the 1945 deficiency. See *McConkey* v. *Comm'r*, 199 F. 2d 892 (4th Cir. 1952), *cert. denied* 345 U. S. 924 (1953); *Bendheim* v. *Comm'r*, 2d Cir., decided June 9, 1954.

For the reasons already discussed, we think that this would be so only if the remittance were made under circumstances which would constitute it a satisfaction of a tax liability in whole or in part. In the *McConkey* and *Bendheim* cases, *supra*, the taxpayers made remittances similar to that now under consideration. Each of those remittances was deposited in the Collector's "Suspense Account" and stood, under the authority of the *Rosenman* case, as "a cash bond for the payment of taxes thereafter found to be due," or, in effect, as a continuing offer by the taxpayer to the Collector that he apply the amount to the discharge of a tax liability in whole or in part. And in each of those cases the Collector, after these deposits with their implicit offers had been made, stated a proposed deficiency not in excess of the deposit, thereby indicating unequivocally an acceptance of the taxpayer's offer. Accordingly, the amounts became "collected without assessment" within the meaning of § 271(a)(1)(B), and the taxpayer's sole remedy remaining was an independent suit for refund.

Here, however, the Collector did not accept, explicitly or implicitly, the taxpayer's remittance as a discharge of its tax liability, in whole or in part, nor could he be forced to do so while that liability was still in dispute. Indeed, no deficiency had yet been proposed in 1947. But in 1948 the Revenue Agent proposed a deficiency in excess of the taxpayer's remittance, as to which the Commissioner issued

his deficiency notice on February 16, 1950, and which the taxpayer was free to, and did, contest; and certainly the Commissioner for his part was not required to circumscribe his position in the ensuing litigation in the Tax Court by making application of such remittance to the asserted tax liability. In other words, until the Commissioner, with unequivocal authority of the taxpayer, applied or was required to apply the $108,437.36 remittance as a satisfaction, in whole or in part, of the asserted tax liability, this remittance did not constitute an amount "collected without assessment" within the meaning of § 271, but continued as no more than a deposit voluntarily made by the taxpayer.

Affirmed.

APPENDIX C

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 14th day of July one thousand nine hundred and fifty-four.

Present: HON. CHARLES E. CLARK, HON. CARROLL C. HINCKS, HON. JOHN M. HARLAN, *Circuit Judges.*

LEWYT CORPORATION (Now known as Lewyt Manufacturing Corporation), *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

Appeal from The Tax Court of the United States.

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

/s/ A. DANIEL FUSARO, *Clerk.*

Office - Supreme Court, U. S.
FILED
DEC 1 1954
HAROLD B. WILLEY, Clerk

No. 417

IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

LEWYT CORPORATION (Now known as Lewyt Manufacturing Corporation), *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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REPLY TO RESPONDENT'S MEMORANDUM

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REPLY TO RESPONDENT'S MEMORANDUM

In its memorandum the Government urges that the issuance of a writ be limited to the first two questions raised by the petition, taking the view that the first question should be reviewed to resolve a conflict with *United States* v. *Olympic Radio and Television, Inc.*, No. 10, and that the second question should be reviewed because it is related to the first in that both involve "construction of the same and of closely related language appearing in Section 122 (d)(6.)" (Mem. 1-2, 4.) But the third question likewise involves construction of the same language of Section 122 (d)(6) and is closely related to the first two.

Section 122 (d)(6) provides an adjustment for excess profits taxes "paid or accrued within the taxable year."

Question 1 involves the issue of whether an accrual basis taxpayer can take into account under Section 122 (d)(6) taxes "paid" or only taxes "accrued"; in terms of this case it deals with whether petitioner's 1946 and 1947 net operating losses should be increased by reason of excess profits taxes "paid or accrued" within 1946 and 1947. Question 3 (like Question 2) involves the meaning of the term "paid" and of the term "accrued" as used in Section 122 (d)(6);[1] in terms of this case Question 3 deals with whether petitioner's 1947 net operating loss should be increased by reason of excess profits taxes "paid or accrued" within 1947. Questions 1 and 3 involve construction of the same statutory language and are plainly closely related. A decision with respect to Question 3 is therefore necessary to a meaningful and definitive construction of Section 122 (d)(6).

Indeed Question 3 has a significance which transcends Section 122 (d)(6). The question as to whether a remittance constitutes a payment is a recurring question of law of general importance which arises under a number of different sections of the Internal Revenue Code. (Pet. 16-18.) Contrary to respondent's suggestion (Mem. 6), there is no issue of fact involved in Question 3, petitioner having accepted all of the findings of the Tax Court when

[1] Although respondent suggests otherwise (Mem. 5), Question 3 bears precisely the same relationship to Question 1 as does Question 2, there being similar alternative arguments in each instance depending upon the decision of Question 1. If petitioner prevails under Question 1, the issue under Questions 2 and 3 will be the amounts of excess profits taxes deemed to have been "paid" in 1944 (Mem. 4, footnote 3) and 1947, respectively. If respondent prevails under Question 1, the issue under Questions 2 and 3 will be the amounts of excess profits taxes deemed to have "accrued" in such years. In the case of Question 2, petitioner contends that accrual took place in the amount it reported as its tax liability on its tax return for 1944; in the case of Question 3, petitioner contends that accrual took place in the amount of contested taxes it paid in 1947. The reasoning which leads respondent to conclude that Question 2 is closely related to Question 1 (Mem. 4) therefore necessarily leads to the conclusion that Question 3 is likewise closely related to Question 1.

it petitioned for a review to the Circuit Court of Appeals. The issue of law involved was described by counsel for the Government at the hearing before the Tax Court as follows (R. 66):

> "* * * *we will have the question of law whether payments tendered to the Collector when there are no assessments against which they are to be applied, if they can be taken to be payments of tax* * *." (Italics supplied.)

The holding of the Court of Appeals here in issue constitutes another instance of the conflict in the decisions as to whether a remittance in advance of assessment constitutes a payment of tax or a deposit. Although respondent here denies the existence of the conflict and the importance of the "payment" problem, one of his chief legal officers (R. P. Hertzog, Assistant Chief Counsel of the Internal Revenue Service) states in the current (November 1954) issue of Taxes (p. 855, at 859) that under the Internal Revenue Code of 1939 there are

> "* * * a group of related problems dealing with whether a remittance is a payment of tax or a mere deposit. This is important insofar as the statute of limitations as to refunds is concerned, and as to whether there exists a deficiency after such a remittance and whether such a remittance is a payment for interest purposes. The decisions in this area are somewhat difficult to reconcile. It may be that the same payment can be regarded as not the payment of the tax for purposes of starting the statute of limitations, as a payment of the tax for purposes of denying jurisdiction to the Tax Court, and as or as not the payment of a tax for interest purposes, depending upon which court one goes into."[2] (Footnotes omitted.)

These conflicting results have been reached in the face of this Court's admonition in *Rosenman* v. *United States*,

[2] The conflict in the "payment" cases is also pointed out in the articles quoted or cited in the petition herein at page 13, footnote 7, page 16, footnote 13, and page 19.

323 U. S. 658 at 661 (1945), that "It will not do to treat the same transaction as payment and not as payment, whichever favors the Government."

Respondent maintains that *McConkey* v. *Commissioner*, 199 F. (2d) 892 (C.C.A. 4th, 1952), *cert. den.*, 345 U. S. 924 (1953), and *Bendheim* v. *Commissioner*, 214 F. (2d) 26 (C.C.A. 2d, 1954) (where the contest as to liability continued, as in the instant case, after the remittances were made) are not in conflict with the decision below.[3] That a conflict does exist, however, is highlighted by the Hertzog article to which reference has just been made. The cases there cited to illustrate the different results reached in different courts as to identical payments are, on the one hand, the *McConkey* and *Bendheim* cases and, on the other hand, *Thomas* v. *Mercantile National Bank at Dallas*, 204 F. (2d) 943 (C.C.A. 5th, 1953), a case cited by respondent (Mem. 6) to sustain the decision below. The *Mercantile National Bank* case does indeed sustain the decision below, and it is therefore apparent that *McConkey* and *Bendheim*, which are in conflict with *Mercantile National Bank*, are also in conflict with the decision below.

Since even the attempted distinction of *McConkey* and *Bendheim* could have no possible application (Pet. 15) to *Standard Portland Cement Co.* v. *Commissioner*, 80 F. (2d) 585 (C.C.A. 3d, 1935) (a case which the Court below failed to discuss), respondent dismisses the plain conflict with that case by the statement that the taxpayer there made the payment unconditionally. (Mem. 7.) But the taxpayer here also made the remittances unconditionally; the opinion of the Court below does not suggest in any way that they were conditional.[4] The opinion below is predi-

[3] Respondent merely restates (Mem. 6) the distinction of these cases which the Court below sought to make and fails to meet the discussion thereof at pages 12-15 of the petition herein.

[4] The lower Court did not adopt respondent's argument below that the remittances were conditional. And even if the remittances had been conditional when made, the alleged condition would have been satisfied long before the instant case was insti-

cated solely on the ground that the contest as to tax liability continued after the remittance was made,[5] a circumstance which also was present in the *Standard Portland Cement* case. As set forth in the petition herein (pp. 13, 15), that case is squarely in conflict with the decision below.

CONCLUSION

The petition for a writ of certiorari should be granted with respect to all three questions raised by the petition.

Respectfully submitted,

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tuted. Hence, the ground suggested by respondent for distinguishing the *Standard Portland Cement* case could not possibly apply with respect to one of the issues involved in Question 3, namely, whether after the substantive issues herein are determined, petitioner should be given credit for the remittance of 1945 taxes here in issue in computing the correct amount of the 1945 deficiency in this case. (Pet. 13.)

[5] Respondent cites the *Rosenman* case, *supra* (Mem. 6), in support of the decision herein. But the Court below did "not read *Rosenman* to foreclose treating as a tax payment any remittance made prior to assessment." (Pet. 36.) And the *Rosenman* decision (which involved a remittance made prior to the filing of a tax return and not one made, as in this case, after the Commissioner had issued a statutory deficiency notice) was not grounded in any way, as was the decision below, on the continuance of a contest as to liability after the remittance was made.

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No. 417

IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

LEWYT CORPORATION (now known as LEWYT MANUFACTURING CORPORATION), *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE.

On Writ of Certiorari to the United States Court of Appeals For the Second Circuit

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BRIEF FOR PETITIONER

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BRIEF FOR PETITIONER

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 23) is reported in 18 T. C. 1245. The opinion of the Court of Appeals for the Second Circuit (R. 57) is reported in 215 F. (2d) 518.

JURISDICTION

The judgment of the Court of Appeals was entered July 14, 1954. (R. 74.) A timely petition for rehearing, filed on July 28, 1954, was denied on August 24, 1954. (R. 75.) The petition for a writ of certiorari was filed on October 20, 1954 and was granted on December 6, 1954. (R. 75.) The jurisdiction of this Court rests on 28 U. S. C. Section 1254 (1).

QUESTIONS PRESENTED

1. Whether excess-profits taxes paid within a taxable year with respect to a taxpayer's excess-profits tax liability for taxes accrued in the preceding year constitute excess-profits taxes "paid or accrued within the taxable year" under Section 122 (d)(6) of the Internal Revenue Code so as to enable a taxpayer on the accrual basis to add the amount of such taxes to its net operating loss for the taxable year in which they were paid.

2. Whether under Section 122 (d)(6) and Section 122 (b)(1) of the Internal Revenue Code the "tax imposed by Subchapter E of Chapter 2 [Excess-Profits Tax] * * * accrued within the taxable year" is the excess-profits tax computed on the basis of the facts existing at the end of such taxable year (as shown on the taxpayer's return for such year) or whether it is the excess-profits tax ultimately determined to be due after application of a carry-back and other circumstances arising in a later year.

STATUTE INVOLVED

The directly pertinent statutory provisions (Sections 21 (a), 23 (s), 41, 43, 48(c) and 122 of the Internal Revenue Code of 1939),[1] together with certain other provisions of the Code and of revenue acts also involved, are set forth in Appendix A, pp. 53-65.

STATEMENT

The material facts, which are not in dispute, are as follows:

This case involves deficiencies determined by the Commissioner of Internal Revenue of income tax for the taxable year ended September 30, 1944, and of excess-profits tax for the taxable year ended September 30, 1945.[2] (R. 2.)

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[1] All references to the "Internal Revenue Code" or to the "Code" are to the "Internal Revenue Code of 1939."

[2] Each fiscal year is hereafter designated simply by the calendar year in which it ended.

The dispute to which this Court has confined its review (R. 75) relates to whether the Commissioner of Internal Revenue was correct (Question 1) in limiting the taxpayer's net operating loss deduction for 1944 (based upon a net operating loss in 1946) to $164,326.38, and (Question 2) in not allowing any net operating loss deduction for 1945 based upon petitioner's 1946 net operating loss, whatever it may be.

Question 1. Amount of 1946 Net Operating Loss. Section 23 (s) of the Code provides that in computing net income there shall be allowed "the net operating loss deduction computed under section 122." (Appendix A, p. 54.) The net operating loss *deduction* for any year is based upon *"net operating losses"* incurred in other years and the net operating loss deduction for 1944 in this case depends upon the amount of taxpayer's net operating loss in 1946.

Section 122 (a) of the Code defines the term "net operating loss" to mean "the excess of the deductions allowed by this chapter [Chapter 1—Income Tax] over the gross income, with the exceptions, additions, and limitations provided in subsection (d)." (Appendix A, p. 57.) The parties are agreed that for 1946 the net operating loss is $164,326.38 without taking into account the adjustment under subsection (d)(6) of Section 122. (R. 24, 38.) The dispute under Question 1 is confined to whether the taxpayer is entitled to make a "(d)(6)" adjustment in 1946.

Section 122 (d)(6) provides that "There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 [Excess-Profits Tax] *paid or accrued* within the taxable year * * *." (Appendix A, p. 59.) The taxpayer files its income and excess-profits tax returns on the accrual basis. (R. 24, 38.) Since, as indicated above, the taxpayer incurred a loss in 1946, no excess-profits tax liability arose (accrued) in that year. However, in 1946 the taxpayer paid the amount of the excess-profits tax

liability ($861,118.04) accrued and shown on its return for 1945.[3] (R. 25, 38.)

The Commissioner determined that this payment did not constitute excess-profits taxes "paid or accrued within the taxable year" 1946 under Section 122 (d)(6) and hence could not be added to the taxpayer's admitted net operating loss of $164,326.38 for 1946. (R. 2-3.) The Tax Court (R. 23) and the Court of Appeals (R. 57) affirmed, ruling that under Section 122 (d)(6) an accrual basis taxpayer could not add to its net operating loss for a taxable year the amount of excess-profits taxes *paid* within such taxable year on account of its liability for taxes accrued in the previous year. Taxpayer contends that such tax payment should be included in its 1946 net operating loss and that its total 1946 net operating loss should therefore be $1,025,444.42 instead of $164,326.38 as contended by the Government.

Question 2. 1946 Net Operating Loss Carry-Back to 1945. Question 2 relates to how much, if any, of the 1946 net operating loss (determined under Question 1) may be carried back to 1945 and taken as a net operating loss deduction in that year. Section 122 (b)(1) (Appendix A, p. 57), as applied to this case, provides that the amount of the 1946 net operating loss which may be carried back to 1945 is "the excess, if any, of the amount of such net operating loss over the net income for" 1944 "computed (A) with the" adjustment "provided in subsection (d) * * * (6) [of Section 122], and (B) by determining the net operating loss deduction for" 1944 "without regard to such net operating loss." The computation of 1944 net income required under clauses (A) and (B) is as follows:

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[3] After taking into account, among other things, a net operating loss deduction arising out of a net operating loss carry-back from 1947 (R. 11, 13), the Commissioner subsequently determined that taxpayer's excess-profits tax liability for 1945 was a smaller amount. (R. 2.)

(1) Compute 1944 net income by determining the 1944 net operating loss deduction without regard to the 1946 net operating loss (Clause (B) of Section 122 (b)(1)).

(2) Reduce the amount of the 1944 net income as computed in (1) above by the Section 122 (d)(6) adjustment for the "tax imposed by Subchapter E of Chapter 2 [Excess-Profits Tax] paid or accrued within the taxable year" 1944 (Clause (A) of Section 122 (b)(1)).

Under Section 122 (b)(1) the excess of the 1946 net operating loss over 1944 net income, computed as set forth in (1) and (2) above, may be carried back to 1945. Unless the 1946 net operating loss exceeds the 1944 net income (so computed), there will not, of course, be any carry-back to 1945.

There is no dispute that the taxpayer's 1944 net income computed without regard to the 1946 net operating loss (Clause (B); (1) above) was $584,866.81.[4] (R. 70.) The issue under Question 2 therefore is the amount by which such net income should be reduced (Clause (A); (2) above) under Section 122 (d)(6) by reason of "the amount of tax imposed by Subchapter E of Chapter 2 [Excess-Profits Tax] paid or accrued within the taxable year" 1944.

If taxpayer should prevail under Question 1, it contends that the amount of the 122 (d)(6) adjustment to 1944 net income is $759,916.50, the amount of the 1943 excess-profits taxes admittedly *paid* in 1944 (R. 24, 38), rather than, as the Government contends, $140,147.87,[5] the excess-profits tax liability ultimately determined for 1943.

If the Government should prevail under Question 1, then the question will arise, as it did below (R. 71), as to the amount of excess-profits tax *accrued* in 1944. The excess-

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[4] Taxpayer's 1944 net income was determined to be $420,540.43 (R. 4, 9) after allowance of a net operating loss carry-back from 1946 of $164,326.38. (R. 4, 6.) The amount of $584,866.81 set forth in the text is the sum of these amounts.

[5] This figure is set forth at p. 134 of the Original Transcript of Record filed in this Court.

profits tax due as shown on the taxpayer's excess-profits return for 1944 was $625,561.59. (R. 40A, Item 20.) Upon the filing of such return, an assessment of tax was actually made against the taxpayer in such amount.[6] (R. 9.) After taking into account, among other things, a net operating loss carry-back of $164,326.38 subsequently arising in 1946 (R. 4, 6), the Commissioner ultimately determined taxpayer's excess-profits tax liability for 1944 to be $280,540.33.[7] (R. 2, 9.) The Court of Appeals[8] ruled that the "excess profits taxes which accrued for 1944" (R. 72) were this amount,[9] rather than, as taxpayer contends, $625,561.59, the amount of excess-profits taxes shown on the taxpayer's return upon the basis of the facts existing at the end of 1944.

As earlier noted, the 1944 net income adjusted under Section 122 (b)(1)(*B*) was $584,866.81. Having found the excess-profits tax "accrued" in 1944 (the adjustment under Section 122 (b)(1)(*A*)) to be $280,540.33, the Court determined the net income computed as required by Section 122 (b)(1) to be $304,326.48, that is $584,866.81 minus $280,540.33. Since the 1946 net operating loss of $164,326.38 did not, of course, exceed $304,326.48, under the Court's decision none of such loss could be carried back to 1945. (R. 72.)

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[6] Taxpayer filed an amended return (R. 50A) for 1944 prior to the due date of the last installment of tax and hence the total payments ($510,939.23) made for 1944 (R. 39) were smaller than the amount assessed on the basis of its original return.

[7] The amount set forth is that stated in the Opinion below. (R. 71.) This is done for purposes of clarity only since the figure represents the tax *after* debt retirement credit (R. 9) rather than the tax *before* debt retirement credit. A *before* debt retirement figure was used by the Court below (R. 71) in connection with the tax ($625,561.59) shown on the 1944 return. (R. 40A, Item 20.)

[8] The Tax Court did not discuss Question 2, being under the mistaken impression that its decision on Question 1 would dispose of Question 2. (R. 36.) The Commissioner's statutory notice (R. 1) also did not refer to Question 2.

[9] The Court also stated that this was the amount of tax "imposed" for 1944. (R. 71.)

SUMMARY OF ARGUMENT

I

A. Section 122 (a) of the Code provides that "net operating loss" means the excess of deductions over gross income with the addition to such loss (under Section 122 (d)(6)) of excess-profits taxes "*paid or accrued* within the taxable year." The holding of the Court below that an *accrual* basis taxpayer may not take into account under Section 122 (d)(6) taxes *paid* within the taxable year would largely read this provision out of the Code so far as accrual basis taxpayers are concerned and limit its benefits to cash basis taxpayers. This is so because taxes based on income —such as excess-profits taxes—do not, of course, ordinarily arise (*accrue*) in a loss year. On the other hand, excess-profits taxes are *payable* in the year subsequent to the year in which the liability arises. Hence, when a loss year follows a profit year, taxpayers will *pay* the excess-profits taxes for the profit year in the loss year. Thus, under the decision of the Court below, accrual basis taxpayers ordinarily cannot obtain relief under Section 122 (d)(6) whereas cash basis taxpayers ordinarily can.

It is no answer to suggest—as does the Government (Brief in *United States* v. *Olympic Radio and Television, Inc.*, No. 10, p. 18)—that discrimination does not exist because an accrual basis taxpayer may on occasion obtain some benefit under the construction of Section 122 (d)(6) adopted by the Court below if he should settle (and hence "accrue") a contested tax liability of an earlier year in a loss year. Surely, it was not the purpose of the Congress in enacting Section 122 (d) (6) to limit its benefits to the relatively few taxpayers who contest tax liability and thus to make equality the exception and discrimination the rule.

While the Court below candidly recognized "the force" of these equities, it stated it could not take them into account without "ignoring the plain mandate of the statute."

(R. 69.) The Court found this mandate in Section 48 (c) of the Code. That section provides that "When used in this chapter" (Chapter 1, entitled "Income Tax") "the terms * * * 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part." Where applicable (as in the case of Section 23 (c) of the Code), this definition, of course, limits accrual basis taxpayers to deductions for taxes or other amounts accrued within the taxable year. But this definition does not apply to Section 122 (d)(6).

The established rule (*Commissioner* v. *Clarion Oil Co.*, 148 F. (2d) 671 (App. D. C. 1945), *cert. den.*, 325 U. S. 881 (1945), and similar cases, involving virtually identical adjustments to net income for taxes "paid or accrued") is that the term "paid or accrued" may have different meanings in the Internal Revenue Code, and that, where appropriate to carry out the statutory purpose, the ordinary meaning of *either* "paid or accrued" will be applied rather than the statutory definition in Section 48 (c). And this Court has ruled (*Helvering* v. *Morgan's Inc.*, 293 U. S. 121, 128 (1934)), with respect to forerunners of the definition and substantive sections of law here involved, that "The same meaning need not always be attributed to a phrase which, by hypothesis, has more than one meaning for purposes of statutory construction." In that case, the Court adopted the construction which would in its judgment best fulfill the statutory purposes. In this case, where by hypothesis the phrase in issue likewise has more than one meaning, adoption of the meaning of *either* "paid or accrued" is necessary in order to carry out with respect to *all* taxpayers the Congressional purpose of according a deduction for excess-profits taxes so as to provide a loss carry-back for the actual economic loss suffered.

While accepting the *Clarion Oil* rule, the Court below held that line of cases, which arose under Chapter 2 of the Code, not applicable, stating that (R. 68):

> "* * * Chapter 2 contains no provisions comparable to § 48 (c) and § 43 of Chapter 1 defining the phrase 'paid or accrued.'"

In this the Court below was plainly in error, the Court having overlooked Section 507 (a) of Chapter 2 of the Code which states that

> "The terms used in this subchapter [subchapter A of Chapter 2, the statute involved in *Clarion Oil*] shall have the same meaning as when used in chapter 1."

Not being under this misapprehension, the Court of Claims in the *Olympic Radio* case (No. 10) stated it would apply to Section 122 (d) (6) the rule of *Clarion Oil* that Section 48 (c) "should not be applied in all circumstances and regardless of consequences." (108 F. Supp. at 111.) In ascertaining the Congressional purpose in enacting Section 122 (d)(6), the Court of Claims appropriately took into account the discrimination against accrual taxpayers which would result from applying Section 48 (c) just as the Court in *Clarion Oil* (148 F. (2d) at 676) in holding Section 48 (c) inapplicable reasoned that Congress did not intend to discriminate between cash and accrual basis taxpayers.

B. The legislative background of Section 122 (d)(6) evidences a clear Congressional purpose to afford real and not illusory relief to taxpayers under Section 122 (d) (6). Section 105 of the Revenue Act of 1942 changed the base for the corporate income tax by eliminating the *deduction* for excess-profits taxes (theretofore provided in Section 23 (c)(2) of the Code) and substituting (in Section 26 (c) of the Code) a *credit* against *net income* equal to the amount of income subject to excess-profits taxes. "Technical amendments" were therefore necessary where it was desired to extend the benefits of the Section 26 (c) credit, or benefits in lieu thereof, to other sections of the Code in which the terms "net income" or "deductions" were used.

In subsection (c)(2) of Section 105 of the 1942 Act,

the credit in Section 26 (e) of the Code was made applicable to the computation of "section 102 net income." But in the immediately succeeding subsection, subsection (e)(3), which enacted Section 122 (d)(6), of the Code, the draftsmen did *not* make the Section 26 (e) credit applicable to the computation of "net operating loss." The reason is evident. Such credit would have been useless in computing a net operating loss since there would be no income subject to excess-profits tax in a loss year. Congress nevertheless determined that an amendment to Section 122 of the Code was advisable and subsection (e)(3) of Section 105 added the Section 122 (d)(6) adjustment for "taxes paid or accrued within the taxable year" to the Code. This adjustment could only have been designed to permit taxpayers to take into account taxes of other years. Otherwise, it would have been as futile as the Section 26 (e) credit since no taxes can arise in a loss year.

There is another clear indication of a conscious Congressional intent to provide meaningful and not theoretical relief in Section 122 (d)(6). The language of Section 122 (d)(6) was taken virtually verbatim from Section 23 (e)(2) of the Code (as in effect prior to its repeal by the 1942 Act) except that one of four rules set forth therein (Rule A) was omitted. That rule provided:

> "The deduction shall be limited to the tax imposed for the taxable year, but any portion of such tax paid after the taxable year shall be considered as having been paid within the taxable year."

Had this rule been retained, Section 122 (d)(6) would have been futile since there can be no tax imposed in a loss year.

The Government's analysis of the legislative history (*Olympic Radio* Brief, pp. 22-34) is manifestly unsound, it being directed toward proof of the proposition that Congress did not intend to permit a corporation to take "a novel and far-reaching deduction" for taxes "*both* paid

and accrued." (*Olympic Radio* Brief, p. 33.) The contention here and in *Olympic Radio* is that a taxpayer under Section 122 (d)(6) may make an adjustment for taxes *either* paid or accrued. Indeed, the Government does not consider at all subsection (c)(2) of Section 105 of the 1942 Act and attempts to explain the omission from Section 122 (d)(6) of Rule A of Section 23 (c)(2) as an effort by Congress to benefit cash but not accrual basis taxpayers. (*Olympic Radio* Brief, p. 26.) The Government gives no reason why the Congress should have taken such pains to benefit only the comparatively few cash basis corporate taxpayers. And it is hardly credible that, in enacting a "technical amendment" designed "to make it all come out straight," Congress intended *sub silentio* to reverse the policy of according the same treatment to cash and accrual basis taxpayers announced in the preceding year by the Congressional committees when they enacted the predecessor provision of Section 122 (d)(6).

More fundamentally, the Government's analysis of the legislative history (*Olympic Radio* Brief, p. 26 *et seq.*) proceeds in substance on the premise that the Congress made a mistake in policy in enacting Section 122 (d)(6). Thus the Government argues that "the allowance of the tax itself as a deduction" grants a "double benefit," which Congress could not have intended. (*Olympic Radio* Brief, p. 27.) But if it be assumed, *arguendo*, that such is the effect of the allowance of the tax as a deduction, the effect would be identical in the case of cash basis taxpayers. Yet cash basis taxpayers are admittedly entitled to deductions under Section 122 (d)(6). In contrast to the doctrinaire exception taken by the Government to the Congressional policy of permitting a deduction for excess-profits taxes under Section 122 (d)(6), the taxpayer, in its analysis of the legislative history, accepts Section 122 (d)(6) as an expression of the Congressional policy to

permit taxpayers to take into account excess-profits taxes in determining their "net operating" or economic loss.

II

Section 122(b)(1), as applied to this case, permits the 1946 net operating loss to be carried back to 1945 to the extent such net operating loss exceeds the 1944 net income computed by determining the net operating loss deduction for 1944 without regard to the 1946 net operating loss and by reducing such net income by the "(d)(6)" adjustment. Under the decision of the Court below on Question 1, the latter adjustment is for the "tax imposed by Subchapter E of Chapter 2 * * * *accrued* within the taxable year" 1944. The Court below held the tax "accrued" within 1944 was not the tax computed on the basis of the facts existing at the end of such year and shown on the taxpayer's return but was the tax after carry-back from 1946.

But under long-established principles recognized in a specific ruling of the Commissioner, the tax accrued in a taxable year is the tax before carry-back from a later year The Government did not dispute this principle below and, indeed, the opinion of the Court below (R. 71) does not appear to question it. Instead, the Court below fixed the amount which it thought appropriate to carry out the purpose of Section 122 (b)(1) as the Court conceived it and held such amount to be the tax "accrued." Specifically, the Court thought the statutory design required that the tax "accrued" for 1944 must "match" (that is, must be the tax computed upon the basis of) the "income" figure for that year from which it was to be subtracted under subsection (b)(1). Paradoxically, the figure held to be the tax accrued did not in fact "match" the income figure from which it was subtracted by the Court since such tax accrued figure—which was the tax computed on the basis of the income *after* carry-back—was subtracted by the Court from the income *before* carry-back.

More fundamentally, the admitted application of Section 122 (b)(1) to other situations plainly shows that the

statute does not contemplate "matching." For example, the (d)(6) adjustment for a cash basis taxpayer in the year 1944 would be the excess-profits tax paid in that year on *1943 income*. Under Section 122 (b)(1) this figure would be applied to reduce the *1944 income*, which it cannot conceivably "match." Even if it be assumed that the Court below would have been justified in disregarding the "plain mandate" of Section 122 (b)(1) to carry out an overriding Congressional purpose, the purpose attributed by the Court to Congress is therefore specifically negatived by the conceded meaning of Section 122 (b)(1) in other situations.

As already noted, Section 122 (d)(6) permits a deduction for the "tax *imposed* by Subchapter E of Chapter 2 [Excess-Profits Tax] paid or accrued within the taxable year." The Government argued below and intends to argue in this Court (*Olympic Radio* Brief, pp. 21-22) that the amount of the (d)(6) adjustment is the tax "imposed" for the year and that the amount of tax "imposed" is the tax finally determined for the year after application of carrybacks. But the word "imposed" is used in Section 122 (d)(6), as in many other places in the Code where a tax cannot be suitably identified by use of a generic name, merely by way of identification of the particular tax referred to. It is not used in Section 122 (d)(6) in a quantitative sense to define an *amount* of tax, that function being performed by the words "paid or accrued."

This is clearly demonstrated by the language of the Congressional committee reports describing Section 122 (d)(6). The context being such as to make it apparent which excess-profits tax was referred to, the reports stated that Section 122 (d)(6) of the Code allowed "the excess-profits tax *paid or accrued* within taxable years" as a deduction. The word "imposed" does not appear. That the word "imposed" is used in Section 122 (d)(6) by way of reference only is also evident on the face of Section 23 of the Code, which allows a deduction in computing net income for taxes "paid or accrued." There, the word

"imposed" is employed where necessary for identification of a particular tax but not used when generic terms are appropriate. Indeed, as Section 23 (from which Section 122 (d)(6) was derived) has changed its form from time to time a deduction has sometimes been allowed for particular taxes "paid or accrued" without use of the word "imposed," and at other times when required by way of identification the word "imposed" has been employed by way of reference to the *same* taxes. The test for deductibility of such taxes is of course no different when the word "imposed" happens to be used.

Even in instances when employed in a quantitative sense, the word "imposed" customarily denotes the tax *before* carry-back. Thus Section 710 of the Code, the section of law (entitled "Imposition of Tax") "imposing" the Chapter 2E excess-profits tax provided that "There shall be levied, collected, and paid * * * a tax * * *." The tax which was actually levied, collected, and paid ("imposed") in this case is the tax before carry-back. So, also, Section 56 of the Code requires that the "tax *imposed*" for a taxable year shall be paid before the end of the following year, or before any carry-back to such prior taxable year can possibly arise. Indeed, the Commissioner has very recently interpreted other provisions of excess-profits tax regulations which provide for an adjustment for "taxes imposed" as referring to the tax before carry-back.

The Government argues (*Olympic Radio* Brief, p. 21) that "there were not two amounts imposed" for the taxable year there involved but "only one, and that one was the amount which finally became determinable after application" of the carry-back from a later year. If the Government is correct in stating that there was only one tax "imposed," such tax, as has been shown, would be the tax before carry-back. However, candor requires it to be said that the word "imposed" when used in a quantitative sense is sufficiently flexible to mean either the tax "*initially* imposed" or "*finally* imposed." In Section 122

(d)(6) the meaning can only be the tax "initially imposed." The statute speaks of the "tax imposed * * * *accrued within* the taxable year." As noted earlier, the only tax "imposed" which "*accrued within*" the taxable year is the tax before carry-back, that is, the tax *initially* imposed. Even if "imposed" were used in a quantitative sense in Section 122 (d)(6), therefore, it would refer to the tax before carry-back.

The interpretation adopted by the Court below would virtually read the (d)(6) adjustment out of Section 122 (b)(1) for accrual basis taxpayers since it is mathematically demonstrable that under such an interpretation accrual basis taxpayers could not ordinarily obtain the benefit of the (d)(6) adjustment under Section 122 (b)(1). Such a result could hardly be justified even if apparently called for by the "plain meaning" of the statutory language. It can certainly not be justified when it is reached by *disregarding* the "plain meaning" of that language.

ARGUMENT

I

TAXES PAID WITHIN A TAXABLE YEAR BY AN ACCRUAL BASIS TAXPAYER CONSTITUTE TAXES "PAID OR ACCRUED WITHIN THE TAXABLE YEAR" UNDER SECTION 122 (d) (6).

A. To Construe Section 122 (d)(6) Otherwise Will Virtually Read That Section Out of the Code So Far As Accrual Basis Taxpayers Are Concerned Since Excess-Profits Taxes Do Not Ordinarily Accrue in a Loss Year.

Section 122 (a) of the Code (Appendix A, p. 57) provides, insofar as here pertinent, that "net operating loss" means the excess of deductions over gross income, with the addition to such loss (under Section 122 (d)(6)) of excess-profits taxes "paid or accrued" within the taxable year. (Appendix A, p. 59). The Court below held that only a cash basis and not an accrual basis taxpayer could include in his net operating loss taxes paid within the taxable year to meet his tax liability with respect to the preceding year. This holding will largely read Section 122 (d)(6) out of the Code so far as accrual basis taxpayers are concerned and limit its benefits to cash basis taxpayers.

Federal income and excess-profits taxes arising in one year are payable in the succeeding year. (Section 56 (a) and (b) of the Code.) Hence when a loss year follows a profit year taxpayers will *pay* the excess-profits taxes for the profit year in the loss year. Under the decision below a cash basis but not an accrual basis taxpayer can add such a tax payment to his net operating loss under Section 122 (d)(6). Accrual basis taxpayers would be permitted to take deductions only for taxes *accrued* in the year of a net operating loss. But, as pointed out by the Court of Claims in *Olympic Radio and Television, Inc.* v. *United States*, No. 10 (which is in conflict with the decision below), it is "only rarely that a taxpayer would accrue a liability for an excess-profits tax in a year in which it had a net operating loss." (108 F. Supp. 109 at 110.) This is true because in the nature of things taxes based on income cannot arise in a loss year. Hence under the decision below the benefits of Section 122 (d)(6) are, in the language of the Court of Claims, "largely illusory" in the case of accrual basis taxpayers.

The example set forth in the opinion below makes the point graphically (R. 69):

> "* * * A corporation had high profit years in 1942 and 1943 and incurred a $1,000,000 excess profits tax liability in the latter year, which it paid in 1944. In 1944 it had a net operating loss of $500,000, without regard to any § 122 (d)(6) adjustment. If an *accrual* taxpayer, the corporation would not be able to add its excess profits taxes for 1943 to its net operating loss for 1944; if a *cash* taxpayer, it would; and this in turn would mean that the cash taxpayer's net operating loss 'carry-back' to 1942 and 1943 under § 122 (b)(1) would be increased by $1,000,000, whereas the accrual taxpayer's 'carry-back' would remain at $500,000."

In its Brief in this Court in *Olympic Radio, the* Government attempts to answer the argument based on the discriminatory results of the decision below in three ways. First

(*Olympic Radio* Brief, p. 18), it points out that Section 122 (d)(6) will on occasion confer partial benefits on an accrual basis taxpayer under the interpretation adopted below. For example, when taxes of an earlier year have been contested, accrual *to the extent of the amount of taxes in contest* will take place in the year the contest is settled, which may be a loss year. In effect, the Government suggests Congress intended to limit the benefits of Section 122 (d)(6) to the relatively few taxpayers who contest tax liability. But surely it was not the purpose of Congress in enacting Section 122 (d)(6) to make equality the exception and discrimination the rule.[10]

Second, the Government (*Olympic Radio* Brief, p. 19) argues that there are other instances under the Internal Revenue Code where accrual basis taxpayers will receive advantages over cash basis taxpayers. To support this position, it is stated that when the excess-profits tax took effect in 1940 a cash basis (but not an accrual basis) taxpayer was obliged to pay tax on goods sold in 1939 which were paid for in 1940. The Government neglects to add that the reverse was true when the excess-profits tax was repealed. Then an accrual basis (but not a cash basis) taxpayer was obliged to pay tax on goods sold in 1945 but not paid for until 1946. This type of difference in treatment between cash and accrual basis taxpayers equalizes itself over the long run or affects at most years of transition when a provision of law is adopted or repealed. But the discrimination here involved is of a different type. It is not confined to years of transition. It would be a continuing discrimination in *every year* throughout the life of Section 122 (d)(6).

Third, the Government (*Olympic Radio* Brief, pp. 13, 20) refers to the language of *Crooks* v. *Harrelson*, 282 U. S. 55,

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[10] The other situation where under the decision below Section 122 (d)(6) might benefit an accrual basis taxpayer (*Olympic Radio* Brief, p. 19) involves *abnormal* income and would arise even more rarely than the one discussed in the text.

60 (1930) and other cases as to the propriety of consideration of consequences in the interpretation of statutes and as to deductions being matters of legislative grace. Of course broad generalizations such as those referred to can hardly be deemed dispositive of concrete cases. The governing principle, in any event, is set forth in *United States* v. *American Trucking Associations*, 310 U. S. 534 at 543 (1940) where this Court said:

> "There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes. Often these words are sufficient in and of themselves to determine the purpose of the legislature. In such cases we have followed their plain meaning [citing, *inter alia*, *Crooks* v. *Harrelson*]. When that meaning has led to absurd or futile results, however, this Court has looked beyond the words to the purpose of the act. Frequently, however, even when the plain meaning did not produce absurd results but merely an unreasonable one 'plainly at variance with the policy of the legislation as a whole' this Court has followed that purpose, rather than the literal words [citing, *inter alia*, *Helvering* v. *Morgan's Inc.*, 293 U. S. 121 (1934), *infra*, p. 20, involving the net loss *deduction* predecessor of Section 122, described by the Court as a "remedial section"]."[11]

It is significant that both the Court of Claims and the Court below, although reaching different conclusions as to the meaning of Section 122 (d)(6), recognized that the construction adopted below would yield inequitable results

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[11] See, also, *Markham* v. *Cabell*, 326 U. S. 404 at 409 (1945), where with respect to a "remedy" under another statute which "would be quite illusory and ineffective" if the statutory language "were read literally" this Court said: "The process of interpretation also misses its high function if a strict reading of a law results in the emasculation or deletion of a provision which a less literal reading would preserve." And in *Farmers Reservoir & Irrigation Co.* v. *McComb*, 337 U. S. 755 at 764 (1949), this Court stated it had "consistently refused to pervert the process of interpretation by mechanically applying definitions in unintended contexts."

by discriminating against accrual basis taxpayers. Indeed, the Court below stated, "we would not be candid if we failed to recognize the force of what the taxpayer argues here." (R. 69.) However, the Court felt precluded from recognizing these equities by what it deemed the "plain mandate of the statute." (R. 69.) As just indicated, even the "plain meaning" of language would not require that unreasonable or futile results be reached in interpreting a statute. In any event, as shown in the next point of this Brief, the provisions of the Code in which the Court below found its mandate—Sections 43 and 48 (c)—are not applicable to Section 122 (d)(6).

B. The Established Rule Is That the Term "Paid or Accrued" May Have Different Meanings in the Code and That, Where Appropriate to Carry Out the Statutory Purpose, the Ordinary Meaning of Either Paid or Accrued Will Be Applied Rather Than the Definition in Section 48 (c).

Section 48 (c) of the Code provides that "When used in this chapter" (Chapter 1 entitled "Income Tax") "the terms * * * 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part." (Appendix A, p. 56.) Section 43 provides that "The deductions * * * provided for in this chapter shall be taken for the taxable year in which 'paid or accrued' * * * dependent upon the method of accounting upon the basis of which the net income is computed. * * *." (Appendix A, p. 55.) Section 41 is of similar purport. (Appendix A, p. 55.) The Court below held these sections to be a "plain mandate" which controlled Section 122 (d)(6) so that it was precluded from considering the statutory purposes (R. 67) and effects (R. 69) in interpreting that section. The Court therefore ruled that the taxpayer, being on the accrual basis, could not take account under Section 122 (d)(6) of excess-profits taxes *paid* within the taxable year.

In cases governed by Sections 48 (c) and 43 an accrual basis taxpayer may only take into account items accrued

within the taxable year. Thus, an accrual basis taxpayer may only take a deduction *under Section 23 (c)* for taxes accrued with the taxable year.[12] But taxpayer contends that Sections 48 (c) and 43 are not applicable to this case.

It is the established rule that the term "paid or accrued" may have different meanings in the Internal Revenue Code, and that, where appropriate to carry out the statutory purpose, the ordinary meaning of *either* "paid or accrued" will be applied rather than the statutory definition in Section 48 (c). *Commissioner* v. *Clarion Oil*, 148 F. (2d) 671 (App. D. C. 1945),[13] *cert. den.*, 325 U. S. 881 (1945); *Aramo-Stiftung* v. *Commissioner*, 172 F. (2d) 896 (C.C.A. 2d, 1949); *Birmingham* v. *Loetscher Co.*, 188 F. (2d) 78 (C.C.A. 8th, 1951); *Wm. J. Lemp Brewing Co.*, 18 T. C. 586, 600-601, acquiesced in by the Commissioner, 1952-2 C. B. p. 2; *Harry M. Stevens, Inc.* v. *Johnson*, 115 F. Supp. 310 (S.D. N.Y. 1953), on appeal to the Court of Appeals for the Second Circuit.

The Government having acquiesced in the *Clarion Oil* line of cases, the term "paid or accrued" by hypothesis has more than one meaning in the Internal Revenue Code. In a case involving the application of the statutory predecessor of Section 48 (the definition section here involved) to the statutory predecessor of Section 122 (the net operating loss deduction provision), this Court rejected the Government's argument that the phrase "taxable year" (now defined in Section 48 (*a*)) must be given the same meaning throughout the loss carry-forward section (now in Section 122). (*Helvering* v. *Morgan's Inc.*, 293 U. S. 121 (1934), involving Sections 200 (a) and 206 (b) of the Revenue Act of 1926, c. 27, 44 Stat. 9.) The Court, speaking through Mr. Justice Stone, stated (at p. 128):

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[12] The Government's argument on pages 11-16 of its Brief in *Olympic Radio* is primarily addressed to this point, which taxpayer has always conceded.

[13] "It is enough if the tax for that income was *either* 'paid or accrued' in the taxable year." (Italics supplied.) 148 F. (2d) at 676. See, also, 148 F. (2d) at 675.

> "The same meaning need not always be attributed to a phrase which, by hypothesis, has more than one meaning for purposes of statutory construction."

The Court, therefore, adopted the construction of "taxable year" which would in its judgment best fulfill the statutory purposes. Under the authority of that case, the meaning to be accorded "paid or accrued" in Section 122 is that appropriate to carry out the Congressional purpose. As already shown, effectuation of that purpose requires that accrual basis taxpapers be accorded the same right to an effective deduction for excess-profits taxes as Congress admittedly accorded to cash basis taxpayers.

While accepting the *Clarion Oil* rule that the term "paid or accrued" might have a different meaning in the Code than that set forth in Section 48 (c), the Court below held that line of cases, which arose under Chapter 2 of the Code,[14] not applicable under Chapter 1 of the Code, stating that (R. 68):

> "* * * Chapter 2 contains no provisions comparable to § 48 (c) and § 43 of Chapter 1 defining the phrase 'paid or accrued.'"

In this the Court below was plainly in error, the Court having overlooked Section 507 (a) of the Code (Appendix A, p. 61) which states that

> "The terms used in this subchapter [subchapter A of Chapter 2, the statute involved in *Clarion Oil*] shall have the same meaning as when used in Chapter 1."

Not being under this misapprehension, the Court of Claims in the *Olympic Radio* case (No. 10) stated it would apply to Section 122 (d)(6) the rule of *Clarion Oil* that Section 48 (c) "should not be applied in all circumstances and re-

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[14] The Court below did not refer to *Stevens, Inc.* v. *Johnson*, 115 F. Supp. 310 (S.D. N.Y. 1953), *supra*, which arose under Chapter 1 (Section 102) of the Code.

gardless of consequences." (108 F. Supp. at 111.) In ascertaining the Congressional purpose in enacting Section 122 (d)(6), the Court of Claims appropriately took into account the discrimination against accrual basis taxpayers which would result from applying Section 48 (c) just as the Court in *Clarion Oil* (148 F. (2d) at 676), in holding Section 48 (c) inapplicable reasoned that Congress did not intend to discriminate between cash and accrual basis taxpayers.

Once the basic rule of *Clarion Oil* that the Section 48 (c) definition does not necessarily govern throughout the Code is accepted, the pertinent inquiry is into the purposes of Section 122 and the consequences of the application of Section 48 (c) to such section. (Points IA and C of this Brief.) This would be so even if the basis on which the Court in *Clarion Oil* determined not to aply Section 48 (c) was inapplicable here. But much of the reasoning of the Court in *Clarion Oil* is in fact apposite in the case of Section 122, the distinction drawn by the Court below between the two situations being untenable.

The Court below attempted to distinguish *Clarion Oil* on the ground that "the meaning of 'paid or accrued' in § 122 (d)(6) is directly involved in the computation of *net income*, for § 23 (s) allows as a deduction in 'computing net income' under § 23 'the net operating loss deduction computed under Section 122.'" (R. 68.) The Court thought this to be significant because of the first sentence of the following excerpt from the opinion in *Clarion Oil* (148 F. (2d) at 675):

> "* * * But, obviously, this definition [§ 48 (c)] was intended to apply to the method of computing *net income*, and has no reference or relevancy to the subject matter of what, for the purposes of the newly added provision in relation to personal holding companies, is taxable as *undistributed* income. In other words, having determined 'net income' in accordance with the accounting methods of the taxpayer, there is no need to consider whether an ordinary income tax was 'paid'

> or whether it was 'accrued', since in either event it was a deductible item and no longer represented *accumulations* of income * * *."

The distinction drawn by the Court below has at best only a verbal plausibility. It ignores or misapprehends both the fundamental rationale and the technical basis of the decision in *Clarion Oil* as well as the distinction between the net operating loss and the net operating loss *deduction*.

In the situation presented in the *Clarion Oil* case, the adjustment for income and excess-profits taxes "paid or accrued during the taxable year" (Section 505 (a)(1);[15] Appendix A, p. 61) was made, along with other adjustments, after the net income of *that taxable year* was determined to measure the income which a personal holding company would be required to distribute to avoid incurring the personal holding company tax. The Court ruled that Section 48 (c) was intended only to apply in computing taxable net income and would have no relevancy to the computation of income available for distribution to stockholders, or, in other words, that Section 48 (c) was inapposite where the statute sought to adjust taxable net income to produce an adjusted net income figure for special purposes. The Court further stated, as noted earlier, that Congress did not intend for the "taxpayer on an accrual basis * * * [to] be in a better position than the taxpayer on a cash basis" (148 F. (2d) at 676), a result that would have been produced by application of Section 48 (c) to the adjustment for taxes there involved. The technical ground on which the decision rested was that the language of Section 48 (c) applied only to the computa-

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[15] Actually, the applicable provisions in the *Clarion Oil* case were Sections 356 (a) (1) and 357 of the Revenue Act of 1936, as added by the Revenue Act of 1937, c. 815, 50 Stat. 813, § 1. The comparable Code sections cited are identical in all material respects. The Code sections are cited throughout this Brief in the interests of clarity since they were cited by the Court below and since the other cases in the *Clarion* line arose under the Code sections.

tion of *net income* and not to adjustments made after net income is computed.

Although Section 122 deals with a quite different problem from that dealt with in the personal holding company provisions, the two provisions are designed, through similarly worded tax adjustment clauses, to adjust net taxable income or loss so as to produce the income or loss figure required to carry out the particular purposes of each provision. In each case, application of Section 48 (c) would prevent carrying out the purpose the tax adjustment was intended to serve in such case. Thus, the (d)(6) adjustment, which is made after the "net loss" (the negative equivalent of net income) of a taxable year is obtained, was added by the 1942 Revenue Act (Appendix A, pp. 64-65) to a list of adjustments in Section 122 (d) designed to convert tax "net loss" into "net operating" or "economic" loss.[16] Section 48 (c) (which is directed toward the determination of taxable net income or "net loss") would appear to be equally inapposite to an adjustment intended to produce "economic loss," as it is to an adjustment intended to produce income available for stockholders, particularly when, in each case, application of that section would result in discrimination between cash and accrual basis taxpayers. And the same technical basis is present in each case for holding Section 48 (c) inapplicable since the (d)(6) adjustment for "taxes" paid or accrued within the taxable year is made after "net loss" (excess of deductions over gross income) for *such taxable year* is determined. Thus Section 48 (c) applies to the computation of "net loss" but not to the Section 122 (d)(6) adjustment made after "net loss" is determined to produce "net operating loss", just as in the personal holding company cases

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[16] The term "economic loss" is quoted from H. Rep. 855, 76th Congress, 1st Sess., p. 17, 1939—2 C. B. p. 517, the committee report dealing with Section 122 as originally enacted in the Revenue Act of 1939.

Section 48 (c) applies to the computation of net income but not to the computation of undistributed income.

As previously noted, the distinction drawn by the Court below does not take into account the rationale of *Clarion Oil*. Nor can such distinction be sustained on the technical ground suggested by the Court below (R. 68; see p. 22, *supra*) that the Section 122 (d)(6) adjustment is "directly involved" in the computation of net income. Of course, the (d)(6) adjustment enters into the computation of the net operating loss for a taxable year, which, after further adjustments and amalgamation with carry-overs and carry-backs of other years, ultimately produces the net operating loss *deduction*, which deduction enters into the computation of the net income of a *different* year. But the definitions in Sections 48 (c) and 43 even where applicable determine only whether a deduction was paid or accrued in the year in which it is sought to take the deduction. Neither Section 43 nor 48 (c) can possibly apply, therefore, to the net operating loss *deduction* itself. The amount of the net operating loss *deduction* is computed by a specified formula with reference to the "net operating losses" of *other years* and the right to such deduction is not, of course, dependent upon whether such deduction was "paid or accrued" in the year the deduction is taken. Only in computing such *"net operating losses"* [17] of other years is there a question of whether excess-profits taxes were "paid or accrued." And in such other years, as pointed out in the preceding paragraph, the situation is comparable to the *Clarion Oil* line of cases, since the adjustment for taxes "paid or accrued within the taxable year" is made after the "net loss" for

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[17] In *Reo Motors, Inc.* v. *Commissioner*, 338 U. S. 442 at 450 (1950), this Court disposed of arguments made with respect to other questions arising under Section 122 by stating such arguments "ignore the trichotomy plainly established with respect to § 122", the reference being to the *net operating loss*, the net operating loss carry-over and carry-back, and the net operating loss *deduction*.

such taxable year is determined and hence is not governed by Section 48 (c).[18]

The untenability of this distinction of the *Clarion Oil* case drawn by the Court below is also illustrated by the foreign personal holding company provisions of Supplement P of *Chapter 1* of the Code (Section 331, *et seq.*). These closely parallel the personal holding company provisions of Chapter 2 (Section 500, *et seq.*), there being identical adjustments to net income in each case for specified taxes paid or accrued during the taxable year. (Sections 336 and 505; Appendix A, pp. 60 and 61.) However, instead of a penalty tax being levied upon the undistributed Supplement P net income of the foreign personal holding company (as it is (Section 500) in the case of "undistributed subchapter A net income" of domestic personal holding companies), an allocable portion of "undistributed Supplement P net income" is included as a constructive dividend in the *gross income for the same taxable year* of the stockholders of foreign personal holding companies under Section 337. Section 337 was described in the pertinent Congressional committee report [19] as a provision "which treats the income of the foreign corporate entity as the income of the shareholders * * * and requires them to report as their income the undistributed net income of such foreign personal holding companies."

The undistributed Supplement P net income is thus much more "directly involved" in the *computation of net income* than is the net operating loss. The former becomes part of the shareholders' income for the *same taxable year* in which

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[18] The suggestion of the Court below (R. 68) that Sections 43 and 48 (c) govern the computation of the net operating loss *itself* stems from the Court's misconception (p. 21, *supra*) that the *Clarion Oil* decision was reached because such sections were not contained in Chapter 2.

[19] H. Rep. No. 1546, 75th Cong., 1st Sess., p. 14, 1939 C. B. (Part 2), p. 713.

the taxes were "paid or accrued." The latter merely affects the net income of a *different taxable year*. It would hardly be suggested that the *Clarion Oil* decision does not apply to foreign personal holding companies since the foreign personal holding company provisions are modeled on the personal holding company provisions.[20] But since the necessary result of accepting the distinction of *Clarion Oil* drawn by the Court below would be that the *Clarion Oil* decision would not apply to foreign personal holding companies, such distinction is evidently an untenable one.

Although the Government attempts, in its Brief in *Olympic Radio* (pp. 16-17), to distinguish, upon the basis just discussed, the *Clarion Oil* case (in which it has acquiesced), the main thrust of its argument cannot be squared with that decision. Thus, the Government cites (Brief, p. 14) cases like *United States* v. *Anderson*, 269 U. S. 422 (1926), which the Court in *Clarion Oil* held to be "inapposite" because they deal with the deduction under Section 23 (c) of taxes for purposes of "net income." (148 F. (2d) p. 675, footnote 14.) So, also, the Government (Brief, pp. 5, 15) deems it significant that the taxpayer does not suggest a recomputation of the tax for the whole of its operations on a cash basis. But, in the *Clarion Oil* case, the Court did not in any way suggest that the taxpayer there involved recompute all its operations on an accrual basis because it was allowed an adjustment under Section 505 (a) for taxes accrued.[21] Again, the Government (Brief, p. 15,

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[20] Indeed, the committee report on the bill which enacted the foreign personal holding company provisions into law deals with Section 336 (a) (1) (relating to taxes paid or accrued during the taxable year) by referring to the explanation in the committee report of the comparable section of the personal holding company provisions (which were revised in the same bill). H. Rep. No. 1546, 75th Cong., 1st Sess., p. 18, 1939 C. B. (Part 2), p. 717.

[21] *Reo Motors* v. *Commissioner*, 338 U. S. 442 (1950) (cited at *Olympic Radio* Brief, p. 14) merely holds that the "net operating loss" under Section 122 (a) must be computed under the law for the taxable year in which incurred, not under the law for the year

footnote 6) is concerned because taxpayer does not suggest that terms such as "net income" and "taxable year" [22] should be interpreted differently in Section 122 from the way they are understood throughout Chapter 1. But the Court in *Clarion Oil* also did not deem it necessary to its decision to suggest that such terms (which also appear in the personal holding company provisions) should be interpreted differently under such provisions than under Chapter 1.

The prior discussion has shown that the term "paid or accrued" may have different meanings in different sections of the Internal Revenue Code and that the term should be construed in Section 122 (d)(6) so as to carry out the purpose of that section. In the preceding point (IA) of this Brief, the futile role which Section 122 (d)(6) would play in the case of accrual basis taxpayers if Section 48 (c) is

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of the net operating loss deduction. Further, the quoted language applies only to "gross income" and "deductions allowed by this chapter", that is to the computation of "net loss"; it does not refer in any way to *adjustments to* "net loss."

[22] The term "taxable year" has in fact been given different meanings in different contexts by this Court in a case involving the predecessor of Section 122. *Helvering v. Morgan's Inc.*, 293 U. S. 121 (1934), discussed at pp. 20-21, *supra*.

The Government (*Olympic Radio* Brief, p. 15, footnote 7) states that the House committee which recommended the enactment of Section 122 *assumed* that the definitions contained in Section 48 would be applicable to Section 122. To support this, the Government quotes a sentence from the report of that committee (H. Rep. 855, 76th Cong., 1st Sess., p. 17 (1939—2 C. B. p. 517)) stating that "*For the purpose of ascertaining the first, second, or third preceding taxable year*, a fractional part of a year which is a taxable year under Section 48 (a), is a *preceding* taxable year." (Italics supplied.) Far from *assuming* that the definitions in Section 48 would be applicable to Section 122, the House committee apparently recognized that under *Helvering* v. *Morgan's Inc.*, *supra*, this would not necessarily be so except as to situations in which it made its intent clear. Indeed, the committee's careful limitation of the purposes to which the Section 48 (*a*) definition applies under Section 122 indicates that even that subsection does not necessarily apply for all purposes of Section 122.

held applicable has been demonstrated. The succeeding point (IC) will examine the legislative history to show that Congress made a conscious effort to avoid this very futility.

C. The Legislative History Demonstrates That Congress Intended in Section 122 (d)(6) to Provide Real and Not Illusory Relief.

The legislative background of Section 122 (d)(6) evidences a clear Congressional purpose to afford real and not illusory relief to taxpayers under Section 122 (d)(6). Section 122 (d)(6) was enacted as Section 105 (e)(3)(C) of the Revenue Act of 1942. (Appendix A, p. 65.) Section 105 of the 1942 Act, subsections (a) through (d), changed the base for the corporate income tax by eliminating the *deduction* for excess-profits taxes (theretofore provided in Section 23(c)(2) of the Code; Appendix A, p. 63) and by substituting a *credit* (in section 26 (e) of the Code; Appendix A, p. 55) against net income equal to the amount of income subject to excess-profits taxes ("adjusted excess-profits net income").[23] Unlike a deduction, a credit is not automatically

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[23] The change was described in the pertinent committee report (H. Rep. No. 2333, 77th Cong., 2nd Sess., p. 18, 1942—2 C. B. p. 388) as follows:

> "1. Change in the Base for Corporate Tax
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> "Under the present law, the excess-profits tax is computed before the normal tax and surtax, being allowed as a deduction in determining the bases to which those taxes apply. Thus, the portion of the adjusted excess-profits net income not taken by the excess-profits tax is subjected to the normal tax and surtax.
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> "The bill changes this method of determining the tax base by dividing the net income into two portions, one of which is subject to excess-profits tax alone, and the other of which is subject only to normal tax and surtax. Instead of deducting the excess-profits tax itself in determining the normal and surtax bases, the bill deducts, through the form of a credit against net income, the adjusted excess-profits net income, the base upon which the excess-profits tax is computed."

taken into account in computing net income, which is defined (Section 21 (a) of the Code; Appendix A, p. 53) to mean gross income, less *deductions*, but is allowed only to the extent provided in specific sections of the Code (Section 26; Appendix A, p. 55). "Technical amendments" were therefore necessary (Section 105 (e) of the 1942 Act;[24] Appendix A, p. 64), where it was desired to extend the benefits of the Section 26 (e) credit, or benefits in lieu thereof, to sections of the Code in which the terms "net income" or "deductions" were used. Thus, subsection (e)(2) of Section 105 of the 1942 Act (Appendix A, p. 64) amended the definition of "section 102 net income", which was defined to mean "net income" with specified adjustments, so as to allow such credit.

In the immediately succeeding subsection, subsection (e)(3) (Appendix A, p. 64),[25] the draftsmen dealt with the

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[24] This section is entitled "Technical Amendments Made Necessary by Change in Base for Corporate Tax."

[25] The portion of the pertinent committee report (S. Rep. No. 1631, 77th Cong., 2nd Sess., p. 67, 1942—2 C. B. p. 556) dealing with subsections (e) (2) and (e) (3) reads as follows:

> "This section makes other technical amendments required as a result of the change in the base of the corporation tax. *In the case of corporations subject to tax under section 102 of the Code, the credit provided in section 26 (e) is also allowed by an amendment to section 102 (d) (1).* Section 122 of the Code, relating to computation of the net operating loss deduction allowed by section 23 (s) of the Code, is amended so as to allow the excess-profits tax paid or accrued within taxable years (subject to certain rules) as a deduction in computing net operating loss for, and net operating loss carry-over and carry-back from, such taxable years." (Italics supplied.)

The House Report is substantially the same and is set forth in the Government's Brief in *Olympic Radio*, p. 31, footnote 19. However, the italicized sentence quoted above (which appears in both the Senate and House report) is not set forth in the Government's Brief.

definition of "net operating loss" in Section 122 of the Code. This had been defined (in parallel fashion to "section 102 net income") as the excess of *deductions* over gross income with specified adjustments. The draftsmen did not make the Section 26 (e) credit applicable to the computation of "net operating loss" as they had in the preceding subsection made it applicable to the computation of "section 102 net income." The reason is evident. Such credit would have been useless in computing a net operating loss since there would be no income subject to excess-profits tax in a loss year.

The Section 26 (e) credit being inapposite in the case of the net operating loss, the Congress could have determined that no amendment to Section 122 was required or advisable. It did not do so. Instead, subsection (e)(3) of Section 105 of the 1942 Act added the Section 122 (d)(6) adjustment for taxes "paid or accrued within the taxable year" to the Code. The conclusion is inescapable that this adjustment was intended to provide a real benefit to taxpayers in a loss year and not an illusory one. Hence, it could only have been designed to permit taxpayers to take into account taxes of other years. Otherwise, it would have been as futile as the Section 26 (e) credit since no taxes can arise in a loss year.

There is another clear indication of the Congressional intent to permit taxpayers to take into account taxes of other years. The language of Section 122 (d)(6) was taken virtually verbatim from Section 23 (e)(2) of the Code (as in effect prior to its repeal by the 1942 Act). That section (Appendix A, p. 63) permitted a deduction for excess-profits taxes "paid or accrued within the taxable year" subject to four specified rules. Three of such rules were incorporated in Section 122 (d)(6) but a fourth (Rule A) was omitted. That rule provided:

> "The deduction shall be limited to the tax imposed for the taxable year, but any portion of such tax paid after the taxable year shall be considered as having been paid within the taxable year."

Had this rule been retained in Section 122 (d)(6), that section would have been futile since there can be no tax imposed for a loss year. Its omission also indicates a conscious attempt to provide meaningful and not theoretical relief in Section 122 (d)(6).

The Government's analysis of the legislative history (*Olympic Radio* Brief, pp. 22-34) is manifestly unsound, it being directed toward proof of the proposition that Congress did not intend to permit a corporation to take "a novel and far-reaching deduction" for taxes "*both* paid and accrued." (*Olympic Radio* Brief, p. 33.) The contention here and in *Olympic Radio* is that a taxpayer under Section 122 (d)(6) may make an adjustment for taxes *either* paid or accrued. Indeed, the Government does not consider at all subsection (e)(2) of Section 105 of the 1942 Act (which furnishes the key to the Congressional purpose) and attempts to explain the omission from Section 122 (d)(6) of Rule A of Section 23 (c)(2) as an effort by Congress to benefit cash but not accrual basis taxpayers. (*Olympic Radio* Brief, p. 26.) The Government gives no reason why the Congress should have taken such pains to benefit only the comparatively few cash basis corporate taxpayers. And it is hardly credible that, in enacting a "technical amendment" designed "to make it all come out straight",[26]

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[26] The quoted words are those of John O'Brien, Office of Legislative Counsel, House of Representatives, who explained to the Senate Finance Committee the changes from existing law made by the House in the 1942 revenue bill (Sen. Finance Comm. Hearings on H. R. 7378, 77th Cong., 2nd Sess., p. 34 at 41). The full context of the quoted language follows:

> "Now, the rest of the amendments in this section are purely technical amendments relating to getting rid of the deduction for excess-profits tax which is in the present law, and various other amendments particularly in connection with the net operating loss, in order to make them come out right. You see, when you change the basis of corporate tax it involves any number of miscellaneous amendments throughout in order to make it all come out straight."

Congress intended *sub silentio* to reverse the policy of according the same treatment to cash and accrual basis taxpayers [27] announced in the preceding year by the Congressional committees when they enacted the predecessor provision of Section 122 (d)(6).[28]

More fundamentally, the Government's analysis of the legislative history (*Olympic Radio* Brief, p. 26 *et seq.*) proceeds in substance on the premise that the Congress made a mistake in policy in enacting Section 122 (d)(6). Thus the Government argues that the "allowance of the tax itself as a deduction" grants a "double benefit", which Congress could not have intended. (*Olympic Radio* Brief, p. 27.) But if it be assumed, *arguendo*, that such is the effect of the allowance of the tax as a deduction,[29] the effect would be identical in the case of cash basis taxpayers. Yet cash basis taxpayers are admittedly entitled to deductions under Section 122 (d)(6).[30] In contrast to the doctrinaire exception

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[27] "A desire for equality among taxpayers is to be attributed to Congress rather than the reverse." *Colgate-Palmolive-Peet Co.* v. *United States*, 320 U. S. 422, 425 (1943).

[28] "It is provided that the deduction shall be allowed only in computing the income tax imposed for the taxable year for which the excess-profits tax is levied. By providing that any excess-profits tax paid after the taxable year shall be deemed to have been paid within the taxable year, *the same treatment is accorded to taxpayers on the cash basis as is accorded to taxpayers on the accrual basis.*" (Italics supplied.) H. Rep. No. 1040, 77th Cong., 1st Sess., p. 46, 1941—2 C. B. 450; S. Rep. 673 (Part 1), 77th Cong., 1st Sess., p. 37, 1941—2 C. B. 495-496.

[29] The suggestion that a "double benefit" is involved merely reflects the Government's consistent refusal to accept the Congressional policy determination to allow excess-profits *taxes* incurred to be taken into account in computing economic loss.

[30] The same vice is present in the Government's contentions (1) that the purpose of the net operating loss deduction was not to accord taxpayers with loss years advantages over those with stable profits (*Olympic Radio* Brief, p. 27), (2) that Section 122 (d) (6) was enacted as part of a war revenue measure (*Olympic Radio* Brief, p. 27), and (3) that Sections 711 (a) (1) (J) and

taken by the Government to the Congressional policy of permitting a deduction for excess-profits taxes under Section 122 (d)(6), the taxpayer, in its analysis of the legislative history, accepts Section 122 (d)(6) as an expression of the Congressional policy to permit taxpayers to take into account excess-profits taxes in determining their "net operating" or economic loss.[31]

II

THE EXPLICIT MANDATE OF SECTION 122 (b)(1) REQUIRES COMPUTATION OF THE CARRY-BACK TO 1945 IN THE MANNER CONTENDED FOR BY TAXPAYER

A. The Principle of "Matching" Which the Court Below Read Into Section 122(b)(1) Is Specifically Negatived by that Section.

The Court below felt compelled by the "plain mandate" of the statute (R. 69) to hold under Question 1 that an accrual basis taxpayer could take into account under Sec-

711 (a)" (2) (L) support its position. (*Olympic Radio* Brief, p. 32, footnote 20, and p. 34, footnote 21.) These arguments would apply equally to cash basis taxpayers who admittedly are entitled to the benefits of Section 122 (d) (6).

And, in any event, these contentions are intrinsically unsound. Argument (1) ignores the fact that all other adjustments under Section 122 (d), such as inclusion of tax-exempt interest in gross income ((d) (2)) and reduction of the deduction for percentage depletion ((d) (1)), operate to *decrease* net operating loss. Argument (2) ignores the fact that in the same war revenue measure Congress introduced the net operating loss carry-*back* provisions (along with many other substantive amendments), the adverse effect of which on the revenues was much greater than that of Section 122 (d) (6). Argument (3) has been fully considered and rejected both by the Court of Claims (*Olympic Radio* on rehearing, 110 F. Supp. 600) and by the Tax Court (*Robert Reis & Co.*, 20 T. C. 294 at 298 (1953)).

[31] The Government contended below and contends in *Olympic Radio* (Brief, p. 21), in the alternative, that the Section 122 (d) (6) adjustment is limited to the tax "imposed." This contention is discussed in detail in Points II C and D of this Brief.

tion 122 (d)(6) only excess-profits taxes "accrued" within the taxable year. In order to compute the amount of the (d)(6) adjustment for purposes of Section 122 (b)(1)(A), the Court below was thereupon required to determine the excess-profits taxes "accrued" in 1944.

The taxpayer contended below that under well-established principles (see Point II B, *infra*) the excess-profits tax "accrued" for 1944 was the tax computed on the basis of the facts existing at the end of such year and shown on the taxpayer's return for such year, and not the tax ultimately found due after application of a carry-back and other circumstances arising in a later year. The Commissioner did not dispute this principle (which he has repeatedly recognized in his rulings) and based his argument below on the use of the word "imposed" in Section 122 (d)(6) (see Point II C, *infra*). The Court below nevertheless held the excess-profits tax "accrued" for 1944 to be the tax after carry-back. (R. 72.) It made no attempt, however, to discuss the meaning of the word "accrued" or the pertinent authorities. (R. 71.) Instead it indicated that it could not follow the accepting meaning of the word "accrued" because to do so would not comport with the purpose of Section 122 (b)(1) as the Court below conceived it. (R. 71.)

This reasoning could not be reconciled with the literal approach adopted by the Court below under Question 1 even if the statutory purpose assumed by the Court were a supportable one. But, inconsistency apart, the Court's reasoning is untenable because the purpose of Section 122 (b)(1) as conceived by it is one specifically negatived by the conceded meaning of that section.

As earlier noted, Section 122 (b)(1) (Appendix A, p. 57), as applied to this case, permits the 1946 net operating loss to be carried back to 1945 to the extent such net operating loss exceeds the 1944 net income computed (Clause (B)) by determining the net operating loss deduction for 1944 without regard to the 1946 net operating loss

and (Clause (A)) by reducing such net income by the (d)(6) adjustment for taxes "paid or accrued" within the taxable year. Concededly, the starting point, the 1944 net income, is the finally determined net income for such year—$420,540.43 (R. 4; p. 5, *supra*, footnote 4)—"net income" being, of course, under Section 21 (a) the net income computed as required by the provisions of the Code. The amount of the 1946 net operating loss deduction allowed in computing such net income figure was $164,326.38. (R. 24, 38.) Thus the net income before such deduction (Clause (B)) was $584,866.81. (R. 4; p. 5, *supra*, footnote 4.)

Section 122 (b)(1)(A) requires that this amount be reduced by the (d)(6) adjustment for taxes "paid or accrued" within the taxable year. Under the decision below on Question 1, the (d)(6) adjustment was for the tax accrued. The Court below stated as its view that the tax accrued figure must "match" (that is, must be the tax computed upon the basis of) the adjusted "income" figure for that year ($584,866.81) from which it was to be subtracted under subsection (b)(1). (R. 71-72.) The Court held the tax figure which matched the adjusted "income" figure—$584,866.81—was $280,540.33, and that such figure was therefore the tax "accrued." (R. 71-72.) Paradoxically, even if the theory of "matching" be accepted, the figures adopted by the Court did not "match." The amount of $280,540.33 was the tax computed on the net income *after* carry-back—$420,540.43. (R. 4, 9; p. 5, *supra*, footnote 4, p. 6, *supra*). It was not the tax computed on the income *before* carry-back—$584,866.81—from which it was subtracted by the Court. Indeed, the excess-profits tax usually cannot "match" net income, since it is not computed on the basis of "net income" but either on the basis of "adjusted excess-profits net income" or on the basis of (with specified adjustments) "corporation surtax net income." (Section 710 (a)(1) of the Code; Appendix A, p. 61.) The former will invariably, and the latter may occasionally, differ from "net income."

More fundamentally, the admitted application of Section 122 (b)(1) to other situations plainly shows that the statute does not contemplate "matching." Concededly, the (d)(6) adjustment for a cash basis taxpayer in the year 1944 would be the excess-profits tax paid in that year on *1943 income*. Under Section 122(b)(1) this figure would be applied to reduce the *1944 income*, which it cannot conceivably "match." So also, the Court below and the Government agree that an accrual basis taxpayer who settled contested tax liabilities of earlier years within the taxable year may accrue such liabilities in the year of settlement. (R. 69; *Olympic Radio* Brief, p. 18.) Thus, if a taxpayer settled a contested *1942* excess-profits liability in 1944, he would accrue the amount of the contested liability in 1944. Under Section 122 (b)(1) the amount of such accrued tax would be applied to reduce the *1944 income*, a figure which it cannot conceivably "match." And, inherently, a tax "accrued" for a particular year—the amount of which is based on the income computed upon the basis of the facts existing at the end of such year (see Point II B of this Brief, *infra*)—can*not* be expected to "match" the finally determined income for that year. The very use of the term "accrued" tax is inconsistent with the idea of matching of tax against finally determined income.

It is evident, therefore, that, even if the Court below would have been justified in disregarding the "plain mandate" of Section 122 (b)(1) to carry out an overriding Congressional purpose, no such purpose exists here. The purpose relied on by the Court below was based solely on the Court's *a priori* notions. It is nowhere expressed by the Congress and is specifically negatived by the conceded meaning of Section 122 (b)(1) in other situations and by the use of the word "accrued."

B. The Excess-Profits Tax "Accrued" Within the Taxable Year (1944) is the Tax Reported on the Taxpayer's Return on the Basis of the Facts Existing at the End of Such Year. That is the Tax Computed on the Income Before the Carry-Back From 1946.

The "matching" approach which the Court below read into Section 122 (b)(1) plainly being unsound, we turn to an examination of the language of Section 122 (d)(6). If the decision of the Court below on Question 1 be accepted, *arguendo*, Question 2 is limited to a determination of "the amount of tax imposed by Subchapter E of Chapter 2 * * * *accrued* within the taxable year."[32]

In determining accruals within a taxable year events occurring thereafter may not, of course, be taken into account. *Security Flour Mills Co.* v. *Commissioner*, 321 U. S. 281 (1944) and cases there cited. Under that settled doctrine, the tax accrued within a taxable year is the tax computed on the basis of the facts existing in such year despite the occurrence of events in later years which change the amount of tax ultimately found due. *Stanard-Tilton Milling Co.*, 3 T. C. 1026 (1944), acquiesced in by the Commissioner, 1949-1 C. B. p. 3; *United States* v. *Detroit Moulding Corporation*, 56 F. Supp. 754, at 757-758 (E.D. Mich., 1944); Mim. 6444, 1949-2 C. B. p. 11.[33] The tax accrued within a taxable year is therefore the tax on income

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[32] If the taxpayer should prevail on Question 1, there is no dispute that the excess-profits tax *paid* in 1944 was $759,916.50 (R. 24, 38; p. 5, *supra*), the Government's argument in that situation being based on the word "imposed." See Point II C and footnote 37 of this Brief.

[33] To avoid undue complexity the discussion in the text is henceforth couched in terms of the carry-back adjustment but the same principles as to determination of the tax accrued govern the other adjustments to 1944 net income (R. 4) based on events occurring after the taxable year. Thus, the "tax accrued" in a taxable year is the tax on the income of that year before adjustment for renegotiation. *Taylor Instrument Companies*, 14 T. C. 388 (1950), acquiesced in by the Commissioner, 1950-2 C. B. p. 4; Mim. 6597, 1951-1 C. B. p. 20.

before carry-backs arising in later years and is *not* the tax finally determined after taking into account such carry-backs. As earlier noted, the Court below did not discuss the established meaning of the word "accrued" and the Commissioner did not attempt to argue that the tax "accrued" was the tax on income *after* carry-back. The Commissioner could hardly have taken a different position, for he has published a specific ruling (following accepted principles) that under an identically worded provision the tax "accrued during the taxable year" is the tax on income before carry-back.[34] (Rev. Rul. 6, 1953-1 C. B. p. 120.)

That ruling involved Section 102 (d)(1)(A) under which "Section 102 net income" is computed (in parallel fashion to "net operating loss") by reducing the net income by income and excess-profits taxes "paid or accrued during the taxable year." After holding that an accrual basis taxpayer could take into account under Section 102 (d)(1)(A) only taxes *accrued* within the taxable year,[35] the Commissioner went on to rule that income tax liability accrues at the end of a taxable year and that the tax "accrued" under Section 102 (d)(1)(A) is the tax computed before application of a carry-back from the following year. As stated in the ruling:

> "The Federal income tax liability for the taxable year 1950 accrued at the close of such taxable year. The taxpayer was required to compute its Federal income tax and file its return for such year without regard to any net operating loss carry-back. (See S. Rept. 1631, 77th Cong., 2d Sess., C. B. 1942-2, 504, 597.) The amount of the tax so computed constituted a deduction for taxes under section 102 (d)(1)(A) of the Code * * *.

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[34] *Aircraft Steel & Supply Co.* v. *State Commission of Revenue*, 173 Kans. 524, 249 P. (2d) 664 (1952) also specifically so holds (upon the basis of federal authorities) under a provision of the Kansas income tax act which permits a deduction for federal income taxes "accrued" within the taxable year.

[35] *Stevens, Inc.* v. *Johnson*, 115 F. Supp. 310 (S.D. N.Y. 1953), is to the contrary on this point. See p. 20, *supra*.

"In Mimeograph 6444 (C. B. 1949-2, 11) relating to the treatment for Federal income tax purposes of refunds of taxes, the deduction of which in prior years resulted in tax benefits, it is stated: 'Since the decision in *Burnet* v. *Sanford & Brooks Co.* (282 U. S. 359 * * * (1931)), emphasis has been given to the point that income taxation is on an annual basis. So long as an item of income or expense was properly accounted for in one period, no change is justified under this doctrine merely because events in a subsequent period might materially change the treatment of the original item.' * * *

"Accordingly, it is held that in determining the 'section 102 net income' of a corporation which keeps accounts and files returns on the accrual basis, an adjustment in Federal income tax liability for the taxable year 1950 resulting from a net operating loss carry-back from the taxable year 1951 should not be reflected in the tax deduction provided by section 102 (d)(1)(A) of the Internal Revenue Code."[36]

The authorities set forth make it evident that the excess-profits tax "accrued" in 1944 is the tax shown on the taxpayer's return for that year.

C. The Use of the Word "Imposed" in Section 122 (d)(6) Does Not Affect Taxpayer's Contention as to the Computation of the Carry-Back to 1945.

1. The Word "Imposed" is Used in Section 122 (d)(6), as in Many Other Places in the Code, Simply By Way of Description or Identification of the Tax for Which a Deduction is to be Allowed and is Not Intended as a Limitation of the Amount of the Deduction.

As already noted, Section 122 (d)(6) permits a deduction for "the amount of tax *imposed* by Subchapter E of Chapter 2 [Excess-Profits Tax] paid or accrued within the taxable year." The Government argued below and intends

[36] To the same effect is a very recent ruling, Rev. Rul. 55-28, Int. Rev. Bull. No. 3, Jan. 17, 1955, p. 65, discussed at pp. 47-48, *infra*.

to argue in this Court[37] (*Olympic Radio* Brief, pp. 21-22) that the amount of the (d)(6) adjustment is the tax "imposed" for the year and that the amount of tax "imposed" is the tax finally determined for the year after application of carry-backs. The Court below simply stated in its opinion, without discussion, that the "tax which was 'imposed' for 1944 was $280,540.33" (R. 71), the tax finally determined after carry-back. It is doubtful that anything turned on this statement since the Court summarized its conclusion to be that "The excess profits taxes which *accrued* for 1944 were $280,540.33." (R. 72.)

The word "imposed" is used in the Internal Revenue Code in two senses depending upon the context. In contexts such as that of Section 122 (d)(6), that is, where used in conjunction with the words "paid or accrued", it is invariably used by way of identification or description of or reference to a tax for which there is no popular name by which the tax can be suitably identified. In other contexts, the word "imposed" is sometimes used in a quantitative sense, that is to define the *amount* of a tax which is to be levied and collected. This point of the Brief (II C 1) will demonstrate that "imposed" was used in the former sense in Section 122 (d)(6). The next point (II C 2) will show that, even if the word "imposed" had been used in a quantitative sense, the tax "imposed" would be the tax before carry-back.

Deductions or adjustments for taxes provided for under the Internal Revenue Code are typically allowed for specified taxes "paid or accrued within the taxable year." Where such taxes have popular names with a fixed meaning they are usually identified by such names; where they do not have such names they are typically identified (in the same deduction or adjustment section) as the tax *imposed*

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[37] If taxpayer prevails on Question 1, the contention presumably will likewise be, as it was below, that the adjustment for taxes *paid* within the taxable year 1944 is the tax "imposed", which the Government contended below was $140,147.87, the tax ultimately determined to be due for 1943. See p. 5, *supra*.

by the particular section, title or chapter of a particular revenue act or of the Internal Revenue Code. In such situations the use of the word "imposed" is not of course intended to superimpose an additional quantitative limitation upon the test of whether the tax was "paid or accrued" within the taxable year, the function of defining the amount of tax referred to being performed by the words "paid or accrued."

That the word "imposed" is used merely by way of reference in Section 122 (d)(6) is made evident by the committee reports which described the meaning of that section. In the language of the Senate Finance Committee (S. Rep. No. 1631, 77th Cong., 2nd Sess., p. 67, 1942-2 C. B. p. 556):[38]

> "* * * Section 122 of the Code, relating to computation of the net operating loss deduction allowed by section 23 (s) of the Code, is amended so as to allow the *excess-profits tax paid or accrued within taxable years* (subject to certain rules) as a deduction in computing net operating loss for, and net operating loss carry-over and carry-back from, such taxable years." (Italics supplied.)

The committee report uses the words "excess-profits tax paid or accrued." It does not use the word "imposed." That word was unnecessary because from the context it was apparent that the Chapter 2E excess-profits tax was referred to. It is therefore clear that the word "imposed" is used in Section 122 (d)(6) only to designate the particular excess-profits tax referred to, and that the test of deductibility under that section is simply whether the tax was "paid or accrued" within the taxable year.

The usage reflected by Section 122 (d)(6) and the associated committee reports is also well illustrated in Section

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[38] The pertinent language of the House Ways and Means Committee report is similar. H. Rep. No. 2333, 77th Cong., 2nd Sess., p. 65, 1942-2 C. B. p. 423.

23 (c) of the Code from which the language of Section 122 (d)(6) was derived. That section (Appendix A, p. 59) allows a deduction in computing net income for taxes "paid or accrued within the taxable year" with specified exceptions. Some of the excepted taxes, such as Federal income taxes (Clause (A)) and estate and gift taxes (Clause (D)), have recognized popular names and the word "imposed" is not used to describe them. Other excepted taxes, such as specified excess-profits taxes, cannot be identified in this way and hence are identified by reference to the tax "imposed" by particular provisions of law, as, for example, in Clause (B), the "excess-profits taxes *imposed* by * * * Subchapter E of Chapter 2."[39]

This very usage has long been adopted in the pertinent Treasury regulations which currently (Regulations 118) provide as follows with respect to the Section 23 (c) deduction for "taxes paid or accrued within the taxable year" (26 C. F. R. § 39.23 (c)-1):

> "Subject to the exceptions stated in this section * * * taxes *imposed* by the United States, any State or Territory * * * *are deductible* from gross income *for the year in which paid or accrued* (see Section 43)." (Italics supplied)

The rule under Section 23 (c) of the Code and this regulation is that a deduction may be taken for taxes *accrued* within the taxable year even though the tax liability is ultimately reduced because of later events. (Point II B, *supra.*) Acceptance of the Government's contention in this case, therefore, would necessarily require a reversal of that settled rule since the regulations under Section 23 (c) use the word "imposed" in exactly the same sense as used in Section 122 (d)(6).

That the use of the word "imposed" to identify a tax does not add anything to the test of the phrase "taxes

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[39] Other examples of this usage are Sections 336 (a) and 505 (a) of the Code. (Appendix A, pp. 60 and 61.)

paid or accrued" is also graphically illustrated by the changes made in the form of Section 23 (c) from time to time. Upon original enactment in the Second Revenue Act of 1940 (c. 757, 54 Stat. 974, Sec. 201), the Chapter 2E excess-profits tax was not deductible under Section 23 (c) of the Code. Thus Section 23 (c)(1), as amended by the Second Revenue Act of 1940 (Appendix A, p. 62), allowed a deduction for

> "Taxes *paid or accrued* within the taxable year, *except*—
>
> "(1) Federal income, war-profits, and *excess-profits taxes* (other than the excess-profits tax imposed by section 106 of the Revenue Act of 1935 (49 Stat. 1019), or by section 602 of the Revenue Act of 1938 (52 Stat. 567), and *other than the declared value excess-profits tax imposed by section 600*)." (Italics supplied.)

The excess-profits taxes for which deductions were permitted were the so-called declared value excess-profits taxes. Specifically, it will be observed that the deduction for "taxes paid or accrued" was permitted with respect to the declared value excess-profits tax *imposed* by Section 600. In the Revenue Act of 1941 (c. 412, 55 Stat. 687, sec. 202), the Chapter 2E excess-profits tax was made deductible under Section 23 (c) of the Code. Since as a general rule excess-profits taxes would thus be deductible, the form of Section 23 (c) was revised so as to list in the exception clause only those excess-profits taxes which could *not* be deducted. Thus Section 23 (c)(1) was amended (Appendix A, p. 63) to permit a deduction for

> "Taxes *paid or accrued* within the taxable year *except*—
>
> " * * *
>
> "(B) war-profits and excess-profits taxes imposed by Title II of the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery

Act, or section 702 of the Revenue Act of 1934, or by any such provisions as amended or supplemented." (Italics supplied.)

"The declared value excess-profits tax *imposed* by section 600", which was deductible under Section 23 as amended by the Second Revenue Act of 1940, became deductible under the general language "taxes paid or accrued" without any reference to the word "imposed" under Section 23 as amended by the Revenue Act of 1941. This change in form is not even mentioned in the pertinent committee reports, the discussion being confined to the change of law as to the deductibility of the Chapter 2E excess-profits tax. H. Rep. No. 1040, 77th Cong., 1st Sess., p. 46, 1941-2 C. B. p. 450; S. Rep. 673 (Part 1), 77th Cong., 1st Sess., pp. 37-38, 1941-2, C. B. pp. 495-496. The test for deductibility of declared-value excess-profits taxes was, of course, no different under the Code after the Revenue Act of 1941 than it was under the Code prior thereto.

This pattern of usage in Section 23 is especially significant since, as noted in the discussion of the legislative history of Section 122 (d)(6) under Question 1 of this Brief (p. 31, *supra*), Section 122 (d)(6) was taken virtually verbatim from Section 23 (c)(2) of the Code as amended by the Revenue Act of 1941. (Appendix A, p. 63.) And from what has been said it is evident that when Section 23 (c)(2) spoke of "the excess-profits tax imposed by Subchapter E of Chapter 2", the word "imposed" was employed simply by way of identification of the particular excess-profits tax referred to.

2. Even if the Word "Imposed" Were Used in a Quantitative Sense in Section 122 (d)(6), the Tax "Imposed" Would be the Excess-Profits Tax Before Carry-Back.

As earlier noted, the word "imposed" is sometimes used in a quantitative sense. This is true in Section 710 of the Internal Revenue Code (Appendix A, p. 61), the taxing section "imposing" the Chapter 2E excess-profits tax,

the tax for which a deduction is permitted under Section 122 (d)(6). The section is entitled "*Imposition* of Tax" and subsection (a) thereof is entitled "*Imposition.*" Subsection (a) reads as follows:

> "There shall be levied, collected, and paid, for each taxable year, upon the adjusted excess-profits net income, * * * a tax equal to * * *."

In other words, the tax "imposed" is the tax levied, collected, and paid.[40] As indicated in the Statement on p. 6, *supra*, the tax before carry-back was the tax actually levied (assessed), collected and paid in this case. Hence, such amount would be the tax "imposed" if the word were construed in a quantitative sense. The fact that a refund of tax is subsequently made does not negate the fact that the amount originally due was actually *imposed*, that is assessed and paid.

There are other instances in the Code where the context also indicates that "tax imposed", even when used quantitatively, refers to the tax *before* carry-back:

1. Under Section 271(a) of the Code (Appendix A, p. 60), "deficiency" means, insofar as here pertinent, the amount by which "*the tax imposed* by this chapter" exceeds the amount shown on the taxpayer's return. Interest is payable, under Section 292 (a) (Appendix A, p. 60), upon the amount determined as a deficiency. In *Manning* v. *Seeley Tube & Box Co.*, 338 U. S. 561 (1950), this Court held a taxpayer liable to pay interest on a deficiency computed

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[40] In the Internal Revenue Code of 1954 (68A Stat. 3 at 5), a change in terminology was made in Section 1 and other taxing sections. Prior thereto, it was provided that taxes shall be "levied, collected, and paid", as in Section 710 of the 1939 Code quoted in the text. Under the 1954 Code, the taxing sections provide that taxes are "hereby imposed." The committee reports state:

> "* * * The use of the word 'imposed' rather than 'levied, collected, and paid' is only a modernization of language." H. Rep. No. 1337 (83rd Cong., 2nd Sess.), p. A-9; S. Rep. No. 1622 (83rd Cong., 2nd Sess.), p. 159.

on the basis of the tax before carry-back. Under that decision, the term "tax imposed" (which forms the basis for the computation of a deficiency), as used in Section 271 (a), is the tax *before* carry-back.

2. Section 56 of the Code (Appendix A, p. 56) provides that the "tax imposed" for a taxable year shall be paid before the end of the following year, or before any carry-back to such prior taxable year can possibly arise. The term "tax imposed", as used in Section 56, necessarily means the tax before carry-back.

3. Section 3779 (a) of the Code (Appendix A, p. 62) permits a taxpayer to obtain an extension of time "for payment of all or part of any *tax imposed*" for the taxable year immediately preceding the taxable year in which a net operating loss carry-back is *expected* to arise. At the time payment of the "tax imposed" is due, the carry-back has not yet arisen. The term "tax imposed", as used in Section 3779 (a), necessarily means the tax *before* carry-back.

Indeed, the Internal Revenue Service has very recently ruled that (in a context where the term "tax imposed" is used in a quantitative sense), the term means the tax accrued or the tax *before* carry-back. Section 40.458-4 (a)(1) of Regulations 130 (under the Excess-Profits Tax Act of 1950, c. 1199, 64 Stat. 1137), as amended by T. D. 6065, 1954-1 C. B. p. 163, provides in part as follows:

> "* * * In computing accumulated earnings and profits as of the beginning of the taxable year, a taxpayer keeping its books and making its income tax returns on the accrual basis shall, in accordance with the principles applicable in the determination of earnings and profits, subtract the Federal *income and excess-profits taxes imposed* for the preceding taxable year." (Italics supplied.)

In Rev. Rul. 55-28, Int. Rev. Bull. No. 3, Jan. 17, 1955, p. 65, the Internal Revenue Service considered, *inter alia*,

whether under such provision (and the similar language of Section 40.437-5 (c)(2) of Regulations 130, as amended by T. D. 5952, 1952-2 C. B. p. 202, and T. D. 6065, 1954-1 C. B. p. 163) requiring that accumulated earnings be reduced by the "tax imposed" for the preceding taxable year, accumulated earnings should be reduced by the tax before or after carry-back. The Service ruled that under such provision the tax to be taken into account was the tax *before* carry-back. In the language of the ruling (at p. 67)

> "* * * accumulated earnings and profits must be decreased by the amount of accrued Federal income and excess profits tax liability for the preceding taxable year, computed * * * without benefit of any net operating loss * * * carry-back."[41]

The Government argued below, and its Brief in *Olympic Radio* in this Court indicates (at p. 21) it will argue here that "there were not two amounts imposed for" 1944, but "only one, and that one was the amount which finally became determinable after application" of the 1946 carry-back. If the Government is correct in stating that there was only one tax "imposed" for 1944, such tax, as has been shown, would be the tax before carry-back.

Although adoption of the Government's premise that there can be only one tax "imposed" for a taxable year would therefore be to the taxpayer's advantage, candor requires it to be said that this conclusion is based on an unnecessarily rigid conception of the meaning of the word. As already noted, the term "imposed"—when employed in a quantitative sense at all—is typically used in the Code in the sense of the tax actually assessed and paid, that is the tax before carry-back. However, the word "imposed" is sufficiently flexible so that under appropriate

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[41] To the same effect is Rev. Rul. 6, 1953-1 C. B. p. 120, quoted at p. 39, *supra*, to indicate that the tax "accrued" for a taxable year is the tax before carry-back. That ruling involved Section 102 (d)(1)(A), Appendix A, pp. 56-57.

circumstances it might be deemed to refer to the tax ultimately determined to be due even though a larger tax had initially been imposed. Stated otherwise, there can be a tax "*initially* imposed" for a year and one "*finally* imposed" for a year. In Section 122 (d)(6) the meaning can only be the tax "*initially* imposed." The statute speaks of the "tax imposed * * * *accrued within* the taxable year." As already pointed out, the only tax "imposed" which *accrued within* the taxable year is the tax before carry-back, that is, the tax *initially* imposed. The tax *finally* imposed (the tax after carry-back) was not the tax imposed *accrued within* the taxable year. Even if it be assumed, *arguendo*, that the word "imposed" was used in a quantitative sense in Section 122 (d)(6), therefore, it would necessarily refer to the tax *before* carry-back.

D. The Decision Below Would Virtually Read Section 122 (d)(6) Out of the Code in the Computation of Carry-Backs Under Section 122 (b)(1) Insofar as Accrual Basis Taxpayers Are Concerned.

The result of the decision of the Court below or of any other construction which determines the Section 122 (d)(6) adjustment under Section 122 (b)(1) to be the finally determined excess-profits tax after carry-back will be to virtually read Section 122 (d)(6) out of the Code in the case of accrual basis taxpayers,[42] as shown below:

There are two possible types of cases which may arise under Clause (A) of Section 122 (b)(1). In the first, the loss carry-back (from, say, 1946) will equal or exceed the net income (before carry-back) for the second preceding year to which the loss is first carried back (1944). Under any rule which defines the (d)(6) adjustment (for 1944) to be the tax computed on income after carry-back, there will be no (d)(6) adjustment since the carry-back will wipe out all tax liability for the second preceding year (1944) to which the carry-back is first made. In concrete terms

[42] These sections might have a limited application where contested taxes are involved. See p. 17, *supra*.

of this case, if the net operating loss carry-back from 1946 were $584,866.81 (the 1944 net income before carry-back, p. 5, *supra*) or more (as it would be if taxpayer prevails under Question 1), there would be no ultimate tax liability for 1944 and therefore no (d)(6) adjustment in 1944 in computing the amount of 1946 carry-back available in 1945.

The second possible type case is one (like the instant one if the Government prevails on Question 1) where the carry-back (from 1946)—$164,326.38—is less than the income before carry-back—$584,866.81—of the second preceding taxable year (1944). In such a case, the amount of the (1946) carry-back—$164,326.38—is by definition equal to the difference between (1) the income of the second preceding year (1944) before such carry-back, and (2) the income for such year (1944) after such carry-back. In terms of the preceding sentence, the amount of the carry-back is (1) minus (2).

Under the decision below, the amount of such 1946 carry-back available in the immediately preceding year (1945) is the amount by which the 1946 carry-back ((1) minus (2)) exceeds the difference between (1) the income of the second preceding year (1944) before such carry-back and (2A) *the excess-profits tax on* the income for such year (1944) after such carry-back. But in the type of case under consideration, the amount of the carry-back ((1) minus (2)) can never equal (much less exceed) the amount of such difference ((1) minus (2A)), as would be necessary under Section 122 (b)(1) if there is to be a carry-back from 1946 to 1945. This is so because (1) in each case is identical and (2A) is the tax on (2). But the tax computed on an amount of income can never, of course, equal such income.[43] Hence, (1) minus (2) will always be less than (1) minus the tax computed on (2). Under the formula of the Court below, therefore, there will never be any "excess" to carry back to the first preceding year

[43] Under Sections 710 (a)(1)(B) and 15 (a) (Appendix A, pp. 51, 63) the excess-profits tax can never exceed 80% of net income.

(1945). Stated otherwise, the Section 122 (d)(6) tax adjustment, if computed on the income after carry-back, can never be sufficient in amount to reduce the income before carry-back for the second year (1944) below the amount of the carry-back.

This is illustrated by the instant case where the net operating loss carry-back from 1946 as determined below—$164,326.38—is by definition equal to (1) the net income before carry-back—$584,866.81—minus (2) the net income after carry-back—$420,540.43. (P. 5, *supra*, footnote 4.) The excess-profits tax on (2), namely $280,540.33, is, of course, necessarily less than (2). Hence, the net operating loss carry-back ((1) minus (2)) cannot exceed (1) minus the tax on (2) and, under the decision below, there is no carry-back available to 1945. The same result will follow if any other amount of loss carry-back (not in excess of $584,866.81) is substituted for $164,326.38. And, as earlier shown, if there had been a carry-back of $584,866.81 or more, there would have been no ultimate tax liability for 1944 and hence likewise no (d)(6) adjustment in that year under the decision of the Court below.

The result of the interpretation of the Court below, or any other interpretation under which the (d)(6) adjustment is for the finally determined tax computed on income *after* carry-back, will, therefore, be to read Section 122 (d)(6) out of the statute for all practical purposes, insofar as accrual basis taxpayers are concerned, in the computation of carry-backs under Section 122 (b)(1). It would seem that a court would hesitate to reach such a result even if apparently called for by the "plain meaning" of the statutory language. Under Question 1, the Court felt the statutory language demanded a similar result with respect to the application of Section 122 (d)(6) to Section 122 (*a*). But, as this section of the Brief shows, the Court below reached this harsh result with respect to the application of Section 122 (d)(6) to Section 122 (*b*)(*1*), in the teeth of the accepted meaning of the statutory language and by relying on an assumed Congressional purpose negatived by the very provisions of the statute.

CONCLUSION

It has been shown that:

(Question 1.) The construction of "paid or accrued" adopted below will virtually read Section 122 (d)(6) out of the Code in the determination of "net operating loss" under Section 122 (a) so far as accrual basis taxpayers are concerned. This result was reached below although the legislative history discloses a conscious Congressional attempt to provide meaningful relief in Section 122 (d)(6) and although it is well settled that the phrase "paid or accrued" may, when appropriate to carry out the statutory purposes, be construed to mean *either* paid or accrued.

(Question 2.) The recognized meaning of the term tax "accrued" is the tax computed on income before carry-backs arising in later years. The use of the word "imposed" is simply a customary way of designating the particular tax referred to and does not alter this meaning. The concept of "matching" which induced the Court below to disregard the statutory language in interpreting Section 122 (b)(1) is one specifically negatived by other admitted applications of that section. Indeed, in the case of accrual basis taxpayers the decision below will for all practical purposes eliminate the (d)(6) adjustment from the statute in computing carry-backs under Section 122 (b)(1).

For the foregoing reasons, the judgment of the Court of Appeals should be reversed.

Respectfully submitted,

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APPENDIX A

Internal Revenue Code of 1939 [c. 2, 53 Stat. 1; 26 U. S. C. 1940, 1946, and 1952* eds.] with Amendments Applicable to Taxable Years Here Involved:

SEC. 15. [As amended by Sec. 104 (a) of the Revenue Act of 1941, c. 412, 55 Stat. 687] SURTAX ON CORPORATIONS.

(a) [As amended by Sec. 105 (b) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Corporation Surtax Net Income.*—For the purposes of this chapter, the term "corporation surtax net income" means the net income minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e) and minus the credit for dividends received provided in section 26 (b) * * *.
(26 U. S. C. 1940 ed., Supp. III, Sec. 15.)

SEC. 21. NET INCOME.

(a) *Definition.*—"Net income" means the gross income computed under section 22, less the deductions allowed by section 23.

* * * * *

(26 U. S. C. 1952 ed., Sec. 21.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) [As amended by Sec. 202 (a) of the Revenue Act of 1941, c. 412, 55 Stat. 687] *Taxes Generally.*—

(1) *Allowance in General.*—Taxes paid or accrued within the taxable year, except—

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*For convenience the 1952 edition of the United States Code is cited where the provisions as set forth in the 1952 edition were applicable to the years here involved. Earlier editions are cited in connection with certain sections because the 1952 edition reflects amendments to those sections which were not applicable to the taxable years here involved.

(A) Federal income taxes;

(B) [As amended by Sec. 105 (c) (1) of the Revenue Act of 1942, c. 619, 56 Stat. 798] war-profits and excess-profits taxes imposed by Title II of the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery Act, section 702 of the Revenue Act of 1934, or Subchapter E of Chapter 2, or by any such provisions as amended or supplemented;

(C) [As amended by Sec. 158 (b) of the Revenue Act of 1942, *supra*] income, war-profits, and excess-profits taxes imposed by the authority of any foreign country or possession of the United States, if the taxpayer chooses to take to any extent the benefits of section 131.

(D) [As amended by Sec. 202 (a) of the Revenue Act of 1941, *supra*, and Sec. 111 of the Revenue Act of 1943, c. 63, 58 Stat. 21] estate, inheritance, legacy, succession, and gift taxes;

(E) [As amended by Sec. 202 (a) of the Revenue Act of 1941, *supra*, and Sec. 111 of the Revenue Act of 1943, *supra*] taxes assessed against local benefits of a kind tending to increase the value of the property assessed; but this paragraph shall not exclude the allowance as a deduction of so much of such taxes as is properly allocable to maintenance or interest charges; and

(F) [As added by Sec. 111 of the Revenue Act of 1943, *supra*] Federal import duties, and Federal excise and stamp taxes (not described in subparagraph (A), (B), (D), or (E)), but this subsection shall not prevent such duties and taxes from being deducted under subsection (a).

[Sec. 23 (c) as amended by the Second Revenue Act of 1940 appears at Appendix A, p. 62. Sec. 23 (c) as amended by the Revenue Act of 1941 appears at Appendix A, p. 63.]

* * * * *

(s) [As added by Sec. 211 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss De-*

duction.—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * *

(26 U. S. C. 1952 ed., Sec. 23.)

SEC. 26. CREDITS OF CORPORATIONS.

In the case of a corporation the following credits shall be allowed to the extent provi led in the various sections imposing tax—

(e) [As added by Sec. 105 (d) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Income Subject to Excess-Profits Tax.*—In the case of any corporation subject to the tax imposed by Subchapter E of Chapter 2, an amount equal to its adjusted excess-profits net income (as defined in section 710 (b). * * *

(26 U. S. C. 1940 ed., Supp. III, Sec. 26.)

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the

basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *
(26 U. S. C. 1952 ed., Sec. 43.)

SEC. 48. DEFINITIONS.

When used in this chapter—

* * * * *

(c) *"Paid or Incurred," "Paid or Accrued."*—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * * * *

(26 U. S. C. 1952 ed., Sec. 48.)

SEC. 56. PAYMENT OF TAX.

(a) *Time of Payment.*—The total amount of tax imposed by this chapter shall be paid on the fifteenth day of March following the close of the calendar year, or, if the return should be made on the basis of a fiscal year, then on the fifteenth day of the third month following the close of the fiscal year.

(b) *Installment Payments.*—[As amended by Sec. 5 (d) of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126] * * * the taxpayer may elect to pay the tax in four equal installments, in which case the first installment shall be paid on the date prescribed for the payment of the tax by the taxpayer, the second installment shall be paid on the fifteenth day of the third month, the third installment on the fifteenth day of the sixth month, and the fourth installment on the fifteenth day of the ninth month, after such date. * * *
(26 U. S. C. 1946 ed., Sec. 56.)

SEC. 102. SURTAX ON CORPORATIONS IMPROPERLY ACCUMULATING SURPLUS.

* * * * *

(d) *Definitions.*—As used in this chapter—

(1) [As amended by Sec. 138 of the Revenue Act of 1942, *supra*] *Section 102 Net Income.*—The term

"section 102 net income" means the net income, computed without the benefit of the capital loss carry-over provided in section 117 (e) from a taxable year which begins after December 31, 1940, and computed without the net operating loss deduction provided in section 23 (s), minus the sum of—

(A) [As amended by Sec. 202 (b) of the Revenue Act of 1941, *supra*] *Taxes.*—Federal income, war-profits, and excess-profits taxes (other than the tax imposed by Subchapter E of Chapter 2 for a taxable year beginning after December 31, 1940) paid or accrued during the taxable year, to the extent not allowed as a deduction by section 23, but not including the tax imposed by this section or a corresponding section of a prior income-tax law.

* * * * *

(26 U. S. C. 1952 ed., Sec. 102.)

SEC. 122. [As added by Sec. 211 (b) of the Revenue Act of 1939, *supra*] NET OPERATING LOSS DEDUCTION.

(a) [As amended by Sec. 105 (e) (3) (A) of the Revenue Act of 1942, *supra*]. *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [As amended by Sec. 153 (a) of the Revenue Act of 1942, *supra*]. *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by deter-

mining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

(2 *Net operating loss carry-over.*— If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the intervening taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss and without regard to any net operating loss carry-back. For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941 shall be reduced by the sum of the net income for each of the two preceding taxable years (computed for each such preceding taxable year with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and computed by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year.)

(c) [As amended by Secs. 105 (e) (3) (B) and 153 (b) of the Revenue Act of 1942, *supra*] *Amount of Net Operating Loss Deduction.*—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26 (e));

(d) [As amended by Sec. 105 (e) (3) (C) of the Revenue Act of 1942, *supra*] *Exceptions, Additions, and*

Limitations.—The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114 (b) (2), (3), or (4);

(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23 (b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations;

(3) No net operating loss deduction shall be allowed;

(4) [As amended by Sec. 150 (e) of the Revenue Act of 1942, *supra*] Gains and losses from sales or exchanges of capital assets shall be taken into account without regard to the provisions of section 117 (b). As so computed the amount deductible on account of such losses shall not exceed the amount includible on account of such gains.

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be computed with the exceptions and limitations specified in paragraphs (1) to (4) of this subsection.

(6) [As added by Sec. 105 (e) (3) (C) of the Revenue Act of 1942, *supra*] There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or

excess-profits taxes paid to any foreign country or possession of the United States;

(B) Such tax shall be computed without regard to the adjustments provided in section 734; and

(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

* * * * *

(26 U. S. C. 1946 ed., Sec. 122.)

SEC. 271. DEFINITION OF DEFICIENCY.

As used in this chapter in respect of a tax imposed by this chapter "deficiency" means—

(a) The amount by which the tax imposed by this chapter exceeds the amount shown as the tax by the taxpayer upon his return * * *.

(26 U. S. C. 1940 ed., Sec. 271.)

SEC. 292. INTEREST.

Interest upon the amount determined as a deficiency shall be assessed at the same time as the deficiency * * *.

(26 U. S. C. 1940 ed., Sec. 292.)

SEC. 336. SUPPLEMENT P NET INCOME.

For the purposes of this chapter the term "Supplement P net income" means the net income with the following adjustments:

(a) *Additional Deductions.*—There shall be allowed as deductions—

(1) Federal income, war-profits, and excess-profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under section 23; but not including the tax imposed by section 102, section 500, or a section of a prior income-tax law corresponding to either of such sections.

* * * * *

(26 U. S. C. 1952 ed., Sec. 336.)

SEC. 505. SUBCHAPTER A NET INCOME.

For the purposes of this subchapter the term "Subchapter A Net Income" means the net income with the following adjustments:

(a) *Additional Deductions.*—There shall be allowed as deductions.—

(1) Federal income, war-profits, and excess-profits taxes paid or accrued during the taxable year to the extent not allowed as a deduction under section 23; but not including the tax imposed by section 102, section 500, or a section of a prior income-tax law corresponding to either of such sections.

* * * * *

(26 U. S. C. 1952 ed., Sec. 505.)

SEC. 507. MEANING OF TERMS USED.

(a) *General Rule.*—The terms used in this subchapter shall have the same meaning as when used in chapter 1.

* * * * *

(26 U. S. C. 1952 ed., Sec. 507.)

SEC. 710. [As added by Sec. 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974] IMPOSITION OF TAX.

(a) [As amended by Sec. 201 of the Revenue Act of 1941, *supra*] *Imposition.*—

(1) [As amended by Sec. 202 of the Revenue Act of 1942, *supra*] *General Rule.*—There shall be levied, collected, and paid, for each taxable year, upon the adjusted excess-profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax equal to whichever of the following amounts is the lesser:

(A) [As amended by Sec. 202 (a) of the Revenue Act of 1943, c. 63, 58 Stat. 21] 95 per centum of the adjusted excess profits net income, or

(B) [As amended by Sec. 202 (b) of the Revenue Act of 1943, *supra*] an amount which when added to the tax imposed for the taxable year under Chapter 1 (other than section 102) equals 80 per centum of the corporation surtax net income, computed under section 15 or Supplement G, as the case may be, but without regard to the credit provided in section 26 (e) (relating to income subject to the tax imposed by this subchapter), and without regard to 80 per centum of the credit provided in section 26 (h) (relating to credit for dividends paid on certain preferred stock).

* * * * *

(26 U. S. C. 1952 ed., Sec. 710.)

SEC. 3779. [As added by Sec. 4 (a) of the Tax Adjustment Act of 1945, c. 340, 59 Stat. 517] EXTENSIONS OF TIME FOR PAYMENT OF TAXES BY CORPORATIONS EXPECTING CARRY-BACKS.

(a) *In General.*—If a corporation, in any taxable year ending on or after September 30, 1945, files with the collector a statement, as provided in subsection (b), with respect to an expected net operating loss carry-back or unused excess profits credit carry-back from such taxable year, the time for payment of all or part of any tax imposed by chapter 1 or 2 for the taxable year immediately preceding such taxable year shall be extended, to the extent and subject to the conditions and limitations hereinafter provided in this section.

* * * * *

(26 U. S. C. 1946 ed., Sec. 3779.)

Sec. 23 (c) of the Internal Revenue Code of 1939 as Amended by Sec. 506 (b) of the Second Revenue Act of 1940 [c. 757, 54 Stat. 974]:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) *Taxes Generally.*—Taxes paid or accrued within the taxable year, except—

(1) Federal income, war-profits, and excess-profits taxes (other than the excess-profits tax imposed by section 106 of the Revenue Act of 1935 (49 Stat. 1019), or by section 602 of the Revenue Act of 1938 (52 Stat. 567), and other than the declared value excess-profits tax imposed by section 600);

* * * * *

(26 U. S. C. 1940 ed., Sec. 23.)

Sec. 23 (c) of the Internal Revenue Code of 1939 as Amended by Sec. 202 (a) of the Revenue Act of 1941 [c. 412, 55 Stat. 687]:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) *Taxes Generally.*—

(1) *Allowance in general.*—Taxes paid or accrued within the taxable year, except—

* * * * *

(B) war-profits and excess-profits taxes imposed by Title II of the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery Act, or section 702 of the Revenue Act of 1934, or by any such provisions as amended or supplemented;

* * * * *

(2) *Excess-profits tax under chapter 2E—special rules.*—For the purposes of this subsection, in the case of the excess-profits tax imposed by Subchapter E of Chapter 2—

(A) The deduction shall be limited to the tax imposed for the taxable year, but any portion of such tax paid after the taxable year shall be considered as having been paid within the taxable year;

(B) No reduction in such tax shall be made by reason of the credit for income, war-profits, or

excess-profits taxes paid to any foreign country or possession of the United States;

(C) Such tax shall be computed without regard to the adjustments provided in section 734; and

(D) Such tax, in the case of a consolidated return under section 730, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

* * * * *

(26 U. S. C. 1940 ed., Supp. I, Sec. 23.)

[Sec. 23 (c) as amended by later Revenue Acts appears at Appendix A, p. 53]

Revenue Act of 1942 [c. 619, 56 Stat. 798]:

SEC. 105. TAX ON CORPORATIONS.

* * * * *

(e) *Technical Amendments Made Necessary by Change in Base for Corporate Tax.*—

* * * * *

(2) *Computation of section 102 net income.*—Section 102 (d) (1) (relating to the definition of section 102 net income) is amended by inserting at the end thereof the following new subparagraph:

"(D) *Income Subject to Excess-Profits Tax.*—The credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e)."

(3) *Computation of net operating loss deduction.*—Section 122 (relating to net operating loss) is amended as follows:

(A) Subsection (a) is amended to read as follows:

"(a) *Definition of Net Operating Loss.*—As used in this section, the term 'net operating loss' means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d)."

(B) Subsection (c) is amended by striking out the parenthesis at the end thereof and inserting in lieu thereof the following: "and without the credit provided in section 26 (e))".

(C) Subsection (d) is amended by striking out "exceptions and limitations" and inserting in lieu thereof "exceptions, additions, and limitations" and by inserting at the end thereof the following new paragraph:

"(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

"(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or excess-profits taxes paid to any foreign country or possession of the United States;

"(B) Such tax shall be computed without regard to the adjustments provided in section 734; and

"(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary."

Office Supreme Court, U. S.
F I L E D
APR 13 1955
HAROLD B. WILLEY, Clerk

No. 417

IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

LEWYT CORPORATION (NOW KNOWN AS LEWYT MANUFACTURING CORPORATION), *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

INTRODUCTION

The Government's brief is devoted primarily to an attempt to establish by the use of elaborate but arbitrary examples that "sweeping and truly astonishing results" will flow from acceptance of petitioner's contentions. (Br. p. 38) We shall show that this is not the case. We shall also show that if, *arguendo*, the Government's examples be accepted as representative, equally "astonishing" results

would flow in parallel examples where a taxpayer is admittedly entitled to benefit from a Section 122 (d)(6) adjustment. In other words, the results which the Government objects to are inherent in Section 122 (d)(6).

What the Government is really arguing therefore is that the Congress made a mistaken policy judgment in enacting Section 122 (d)(6). The appropriate forum for such an argument is the Ways and Means Committee of the House of Representatives and not this Court.

POINT 1 OF RESPONDENT'S BRIEF

A. The Argument That Adoption of Taxpayer's Position "Would Cause Gross Discrimination in Favor of Taxpayers Having Fluctuating Income as Opposed to Those With Stable Earnings" Is Untenable.

The principal argument made by the Government is one urged on, but not adopted by, the Court below—namely, that acceptance of "taxpayer's legal position as to the meaning of 'paid or accrued' * * * would cause gross discrimination in favor of taxpayers having fluctuating income as opposed to those with stable earnings." (Br. p. 18.) This suggestion is untenable for three separate and independent reasons:

1. The examples chosen by the Government are entirely arbitrary, and examples showing exactly the reverse can readily be set forth. If a Section 122 (d)(6) adjustment is made as a result of acceptance of taxpayer's contention, it is just as likely that taxpayers with fluctuating income will still pay greater taxes than taxpayers with stable earnings as it is that the reverse will be true. Thus, the Government's examples all assume that the only adjustment under Section 122 (d) will be the (d)(6) adjustment. This is the only adjustment under subsection (d) which operates to *increase* the amount of a net operating loss, all other adjustments under that subsection acting to *decrease* the amount of a net operating loss. When the amount of such other adjustments under subsection (d)

equals or exceeds the amount of the (d)(6) adjustment, a taxpayer with fluctuating income will invariably pay more taxes than one with stable income even if petitioner's contentions prevail. And, when such other adjustments are not involved, there are still many cases, as illustrated by Example A in the appendix hereto, where a taxpayer with fluctuating income who makes a (d)(6) adjustment in the manner contended for by petitioner will pay more taxes than one with stable income. This is true because a taxpayer who suffers loss years will not obtain in such years the benefit of specific excess-profits exemptions and graduated normal tax and surtax rates available in all years to taxpayers with stable incomes.

2. The very examples selected by the Government—which are patently the most favorable from its standpoint—show on their face that *if the Government prevails* a taxpayer with fluctuating income will pay more tax than one with stable income. Thus Example 3 (Respondent's Brief, Appendix B, p. 23a) shows that, if the Government prevails, the taxpayer in the example with fluctuating income will pay $284,650 in taxes over a four-year period whereas the taxpayer with stable earnings in the same aggregate amount will pay only $205,075. Again, in Example 1 (Respondent's Brief, Appendix B, p. 12a) which, the Government states, sets forth the case of a stable income taxpayer with aggregate income the same as petitioner's, such taxpayer would pay $427,393.32 in taxes. Yet under the decision of the court below, which the Government seeks to justify, the petitioner will be required to pay $567,650.91 in taxes. (Respondent's Brief, p. 14.) Hence, if these examples were representative, they would at best show that acceptance of petitioner's contentions would favor taxpayers with fluctuating income over those with stable earnings whereas acceptance of the Government's contentions would favor taxpayers with stable earnings over those with fluctuating earnings.

The Government offers no reason why this Court should choose the latter alternative over the former. Indeed, as stated by the Government in its brief in *United States* v. *Olympic Radio and Television, Inc.*, No. 10, at p. 27, the Congressional committee reports make it clear that "the underlying purpose in the enactment of the net operating loss deduction was to avoid tax discrimination against businesses with alternating or fluctuating profit and loss years in favor of those with stable profits year in and year out." The Government's own examples show that acceptance of its contentions would perpetuate the discrimination which Congress sought to end. The "discrimination" argument, therefore, is hardly one in favor of the Government. Certainly there is no basis for giving that argument countervailing weight against the fact that the decision below will virtually read Section 122 (d)(6) out of the statute so far as accrual basis taxpayers are concerned. (Petitioner's Main Brief, p. 15 *et seq.*)

3. Even in the limited situations covered by the Government's examples, the results to which it objects are inherent in Section 122 (d)(6) and are not the result of acceptance of petitioner's contentions. The same results would necessarily follow in any comparable case where a taxpayer was entitled to a deduction under Section 122 (d)(6). Thus, in Example 3, the consequences which the Government calls "extravagant" (Br. p. 19), would concededly ensue if the taxpayers in the example were on a cash basis. This would also be true if the accrual basis taxpayer in that example (Taxpayer C) paid in 1946 contested excess-profits taxes for a prior year such as 1942. The Government does not argue that cash basis taxpayers or accrual basis taxpayers who pay contested taxes in loss years should be precluded from taking a Section 122 (d)(6) adjustment because of the "discrimination" which would thereby result in favor of taxpayers with fluctuating income. Its argument that this taxpayer should be precluded from doing so for that reason is therefore plainly untenable.

A similar argument was made by the Government in an abortive effort—since abandoned—to deny Section 122 (d)(6) adjustments even to accrual basis taxpayers who settled contested taxes in loss years. (*Robert Reis & Co.*, 20 T. C. 294 (1953), quoted with approval in the Government's brief in *Olympic Radio*, No. 10, at p. 18.) The reasoning of the Tax Court in making short shrift of that argument is applicable here (20 T. C. at 298):

> "* * * If we accept this argument, it would mean that a cash basis taxpayer in the same situation as the petitioner could not claim the deduction in 1949, though that was the year in which the taxes were paid, for to allow a cash basis taxpayer the deduction in 1949 would distort his excess profits years just as much as in the case of a taxpayer using the accrual system. The respondent does not argue that a cash basis taxpayer could not have the deduction in 1949. We do not accept the argument."

Since the results which the Government objects to in its examples will also occur in *every* comparable case where a Section 122 (d)(6) adjustment is made, it is evident that what the Government is objecting to is the principle adopted by Congress in enacting Section 122 (d)(6). The very enactment of that section gave taxpayers with fluctuating incomes a deduction not given to taxpayers with stable incomes. If that is a "discrimination" in favor of taxpayers who suffer losses over those who do not,[1] it is one conferred by Congress for reasons which Congress found persuasive. The Government argues in effect that

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[1] As earlier noted, the enactment of the net operating loss provisions in the Revenue Act of 1939 merely removed part of the discrimination *against* taxpayers with fluctuating income. The adjustments in subsections (d)(1) through (d)(5) of Section 122 all operated against taxpayers with losses. Also Section 122 did not compensate taxpayers with fluctuating income for loss of specific exemptions or for the impact of graduated rates on pyramided income. The enactment of Section 122(d)(6) and of the carry-back provisions in the Revenue Act of 1942 in a measure redressed the balance.

Congress made an erroneous policy judgment in giving the Section 122 (d)(6) deduction to taxpayers with loss years. In the Excess Profits Tax Act of 1950,[2] Congress made Section 122 (d)(6) inapplicable with respect to any taxable year ending after June 30, 1950. The Government asks this Court to do what Congress did not do—to make Section 122 (d)(6) inapplicable from the date of its enactment.

B. The Clarion Oil and Morgan's Inc. Cases Establish That, Where Necessary to Carry Out the Congressional Purpose, as in This Case, the Phrase "Paid or Accrued" May Mean Either "Paid or Accrued."

The Government attempts (Br. p. 19) to set forth circumstances which it believes differentiate the *Clarior Oil*[3] line of cases from this case. Such purported distinctions have already been discussed in taxpayer's main brief (pp. 22-28) and that discussion will not be repeated here. But, even if these distinctions be accepted for purposes of argument, they at most establish that *Clarion Oil* does not *require* that the meaning of *either* paid or accrued be applied to Section 122 (d)(6). Be that as it may, it is indisputable that *Clarion Oil* held that, where necessary to effectuate the Congressional purpose, the words "paid or accrued" will be read to mean *either* paid or accrued and not given the meaning set forth in Section 48 (c). In other words, the phrase "paid or accrued" has more than one meaning in the Internal Revenue Code.

The Government's attempted distinction (Br. p. 23) of *Helvering* v. *Morgan's Inc.*, 293 U. S. 121 (1934), on the ground that "paid or accrued" has "only one statutory meaning" is therefore plainly untenable. The rule enunciated in that case (293 U. S. at 128) with respect to statutory predecessors of the sections here involved that "The same

[2] C. 1199, 64 Stat. 1137, Sec. 304(e).

[3] 148 F. (2d) 671 (App. D.C. 1945), *cert. den.*, 325 U. S. 881 (1945).

meaning need not always be attributed to a phrase which, by hypothesis, has more than one meaning for purposes of statutory construction" is thus applicable. Accordingly, "paid or accrued" should be given that meaning which will best carry out the statutory purposes discussed at length in our main brief (pp. 15-19, 29-34). Although recognizing the force of taxpayer's argument as to such purposes, the court below felt precluded from considering them (R. 69) because it was under the erroneous impression that *Clarion Oil* rested on the ground that the chapter of the Code there involved (Chapter 2) contained "no provisions comparable to § 48 (c) and § 43 of Chapter 1 defining the phrase 'paid or accrued.'" (R. 68.) As shown in our main brief (p. 21), the court below overlooked Section 507 (a) of the Code which expressly made Section 48 (c) applicable to Chapter 2. In the face of the unequivocal statement of the court below just quoted, the Government (Br. p. 21) nevertheless urges that the court below "was not oblivious of Section 507 (a)." The Government does not explain why this is so except by quoting two sentences from the court's opinion which do not in any way mention or refer to Section 507 (a).

C. Subsection (e)(2) of Section 105 of the 1942 Act Makes Manifest the Congressional Purpose to Provide Meaningful and Not Illusory Relief Under Section 122(d)(6).

In our main brief (p. 30, *et seq.*), we argue that subsection (e)(2) of Section 105 of the 1942 Act highlights the Congressional purpose to provide a real benefit to taxpayers in a loss year and not an illusory one. The Government restates what this section does and concludes by adding merely that it was aptly included in Section 105 (e) as a technical amendment. Taxpayer's point was that the reasons which impelled the technical amendment to Section 102 of the Code made by subsection (e)(2) of Section 105 of the 1942 Act were equally applicable to Section 122 of the Code. Yet, in the immediately succeeding subsection of the 1942 Act, subsection (e)(3), Congress made a differ-

ent type technical amendment—the addition of (d)(6)—to Section 122. The reason is evident. The (Code) Section 26 (e) credit which was made available in the case of Code Section 102 would have been futile in the case of Code Section 122 since there can be no Section 26 (e) credit (income subject to excess-profits tax) in a loss year. Section 122 (d)(6) was therefore evidently designed to provide meaningful and not illusory relief, an intent which will be thwarted by adoption of the Government's contention. This argument and taxpayer's other arguments based on the legislative history of Section 122 (d)(6) (Main Brief pp. 29-34) remain unanswered.

POINT 2 OF RESPONDENT'S BRIEF

The Government's brief makes no effort to answer taxpayer's discussion of the language of Section 122 (b)(1) and Section 122 (d)(6). Under Point 1 the Government urges that Section 48 (c) permits an accrual basis taxpayer to take into account only taxes accrued within the taxable year. Under Point 2 taxpayer is simply asking that it be permitted to take into account taxes accrued[4] within the taxable year. In view of the inconsistency of its positions, the Government in its discussion of Point 2[5] understandably has little to say about the statutory language. Instead it urges that acceptance of taxpayer's contentions would produce "truly astonishing" results. (Br. p. 38.)

To support this view, the Government places great emphasis on an *over-all* illustration as to the results of

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[4] If taxpayer prevails on Point 1, it urges that it be permitted to take into account taxes paid within the taxable year. Since, to simplify the discussion, the Government's argument is confined to the "accrued" alternative (Br. p. 33, footnote 22), references to the "paid" alternative will likewise not be repeated in the ensuing portion of this brief.

[5] The Government erroneously states (Br. p. 6) that the Tax Court sustained its position on Point 2. The Tax Court did not pass on Point 2, mistakenly assuming (R. 36) that its decision on Point 1 would dispose of Point 2.

acceptance of taxpayer's contention on *both* Question 1 and Question 2. (Br. pp. 13-15, 17, 25-31.) In making this argument, the Government is really asking this Court not to let taxpayer prevail on both questions but only on one of them. This is the only possible relevance of the over-all illustration for, as the Government in effect admits (Br. p. 17), it could have no logical bearing on *either* Question 1 or Question 2, considered separately, since the illustration does not, of course, isolate the effect of a decision as to either question. We therefore need pause only briefly to examine the over-all illustration. Thus, it should be noted that the same results portrayed would occur on comparable facts where Section 122 (d)(6) admittedly applies (as in the case of cash basis taxpayers or where contested taxes are involved). This being true, the results which the Government objects to are inherent in Section 122 (d)(6). Far from being astonishing, they are results which inevitably occur in many situations under the annual accounting system rather than results occasioned by accepting the contentions made by taxpayer in this case.

Since the Government's over-all illustration has no pertinence to Point 2, taken by itself, the ensuing discussion will be confined to the Government's argument dealing with Point 2 "standing alone." (Respondent's Brief pp. 6, 32-39.) In view of the emphasis given by the Government to the over-all illustration, it is first necessary to set in perspective the income which will be subject to tax if the taxpayer prevails on the second issue only. In that event, taxable income for 1944 will be, as held below, $420,540.43. (R. 4.) The taxable income found by the court below for 1945—$338,818.29[6]—will be reduced by $164,326.38 to $174,491.91.

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[6] The Commissioner found 1945 net income to be $282,865.25. (R. 11.) The Tax Court denied an interest deduction of $55,949.04 allowed by the Commissioner (R. 28-29, 36), thereby increasing taxpayer's 1945 net income to $338,818.29, the figure set forth in the text. See Respondent's Brief, p. 4, footnote 3.

A. The Results Which the Government Objects to Will Necessarily Occur Wherever a Section 122(d)(6) Adjustment Takes Effect Under Section 122(b)(1).

The Government summarizes its argument under Point 2 as follows (Br. p. 6):

> "Taxpayer's theory as to Question 2, standing alone, leads to the conclusion, no less extraordinary, that a 1946 net operating loss may be applied as an offset to net income earned in the second preceding year (1944) and still be available, undiminished in amount, for application against the income of the first preceding year (1945)."

Stated otherwise, the Government objects to the "double benefit" (Br. p. 34) which it claims would result from acceptance of taxpayer's contention.

The argument that adoption of taxpayer's position would cause a "double benefit"[7] simply reflects the Government's consistent refusal to recognize that, under the specific terms of Section 122 (b), Congress has provided that a Section 122 (d)(6) adjustment is to be made. The logic of the Government's "double benefit" contention would effectively preclude *any* taxpayer from ever obtaining *any* benefit whatsoever from the (d)(6) adjustment under Section 122 (b)(1). That this is the necessary result of the Government's position cannot be obscured by semantics such as the "double benefit" argument.

The Government concedes (Br. p. 38) that the meaning which it urges should be attributed to the word "imposed" (see Point 2B, p. 12, *infra*) would result in the ordinary accrual basis taxpayer never receiving any benefit from the Section 122 (d)(6) adjustment under Section 122 (b)(1),

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[7] Even if the Government's theory as to what constitutes a "double benefit" be accepted, *arguendo*, the "double benefit" would not occur in cases where the adjustments under Sections 122 (d)(1) through 122 (d)(5) offset the (d)(6) adjustment. Yet the principle which the Government seeks to establish here would deny a (d)(6) adjustment in such cases even though what the Government calls a "double benefit" could not conceivably occur.

a point demonstrated mathematically in Petitioner's Main Brief at p. 49 *et seq.* It states, however, that a "limited" application would remain for these two sections in the case of cash basis taxpayers and of accrual basis taxpayers who contest taxes or have abnormalities in income. If the Government's "double benefit" theory be accepted, Section 122 (d)(6) and Section 122 (b)(1) would not have even this limited application. As shown below, under that theory those sections would never apply.

What the Government is really arguing, therefore, is not that Section 122 (d)(6) and Section 122 (b)(1) should be construed to avoid a "double benefit" but that they should be construed so as to prevent the allowance of any benefit under any circumstances. In effect, the Government urges that, although Congress deliberately made the (d)(6) adjustment applicable to (b)(1), it is "inconceivable" (Br. p. 33) that Congress intended any benefit ever to arise from such adjustment.

This may be readily illustrated. Let us assume that an accrual basis taxpayer had a net operating loss of $500,000 in 1946 and a net income before carry-back of $500,000 in 1944, that $100,000 of excess-profits taxes accrued with respect to such $500,000 net income in 1944, and that there were no other adjustments under subsection (d) of Section 122 in 1944. Under taxpayer's contention, $500,000 would be carried back to 1944. The carry-back to 1945 would be $100,000 since the (d)(6) adjustment under (b)(1) would reduce the 1944 net income from $500,000 to $400,000, leaving an excess of $100,000 of the 1946 net operating loss ($500,000) over "adjusted" 1944 net income ($400,000). The Government argues that allowance of the (d)(6) adjustment of $100,000 would result in permitting a deduction of $100,000 of the 1946 loss in 1945 although the entire 1946 loss had already been deducted in 1944. But this is the very purpose of the (d)(6) adjustment under (b)(1) to net income of the second preceding year. Let us change the illustration so that either (a) the taxpayer is on a cash basis and $100,000 of excess-profits taxes were paid

in 1944 with respect to 1943 taxes, or (b) the taxpayer is on an accrual basis but the excess-profits tax accrual of $100,000 in 1944 resulted from settlement of 1942 taxes in 1944. In both of such cases, the taxpayers admittedly will be permitted to make a (d)(6) adjustment to 1944 income of $100,000 and hence to take a deduction of $100,000 of the 1946 loss in 1945 although the entire 1946 loss has already been deducted in 1944. Yet if the Government's "double benefit" theory were applied, this would not be permitted and no taxpayer could ever obtain the benefit of the (d)(6) adjustment under (b)(1). The Government does not argue that the (d)(6) adjustment may not be applied to (b)(1) in these situations although on its theory a "double benefit" would result therefrom. Its argument that this taxpayer should not be permitted to make this adjustment by reason of the same "double benefit" that would result therefore falls of its own weight.

What the Government calls "double benefit" could be eliminated from Section 122 only if the amount of net operating loss which could be carried back to the first preceding year were defined as the excess of the loss over the net income (before carry-back) of the second preceding year. Congress did not so provide. Instead it defined the carry-back to the first preceding year as the excess of the loss over the net income (before carry-back) of the second preceding year *reduced by the Section 122 (d)(6) adjustment.* The Government would read the italicized language out of the statute. In essence, the Government contends that Congress exercised mistaken judgment in making Section 122 (d)(6) applicable under Section 122 (b)(1). This is the wrong forum for such an argument.

B. The Amount of the Section 122(d)(6) Adjustment Under Section 122(b)(1) Is the Excess-Profits Tax Accrued in 1944, That Is, the Tax on Income Before Carry-Back.

It is a fundamental principle of tax law that the tax accrued within a year is the tax computed on the basis of the facts existing at the end of such year. Subsequent

events, such as a carry-back from a later year, cannot affect the amount of the original accrual. (Petitioner's Main Brief, p. 38 *et seq.*) Although not questioning this principle, the court below held the tax "accrued" within the year 1944 to be the tax finally determined on the ground that such meaning was necessary to carry out what it deemed to be the statutory pattern (R. 71-72), a ground of decision discussed in detail in Petitioner's Main Brief at pp. 34-37. The Government does not attempt to argue in this Court that the tax "*accrued*" in 1944 was the tax as finally determined in later years. Instead it attempts to sustain the judgment below on other grounds.

The only justification the Government finds in the language of Section 122 (d)(6) for upholding the decision below that the Section 122 (d)(6) adjustment is for the tax finally determined to be due is the use of the word "imposed" in that section. It will be recalled that Section 122 (d)(6) permits a deduction for the "tax *imposed* by Subchapter E of Chapter 2 [Excess-Profits Tax] paid or accrued within the taxable year." In our main brief (pp. 40-49) we have shown in detail that the word "imposed" in Section 122 (d)(6) does not have the meaning the Government seeks to attribute to it. Being unable to controvert this argument, the Government simply repeats its dogma that (Br. p. 34) "There were not two excess-profits taxes imposed for 1944, but only one, and that one was the amount as finally determined * * *." Even if true, this would be irrelevant since, as pointed out in our main brief (p. 40 *et seq.*), the word "imposed" is *not* used in Section 122 (d)(6) by way of limitation of the amount of the deduction. It is there used simply by way of identification of a tax which could not suitably be described by popular name, there also having been a declared value excess-profits tax in effect when Section 122 (d)(6) was enacted. This very understanding is specifically set forth in the pertinent committee reports which described the Section 122 (d)(6) adjustment as allowing a deduction for "the excess-profits tax paid or accrued within taxable years." (Petitioner's

Main Brief, p. 42.) The word "imposed" was not used, since the context made it apparent which excess-profits tax was referred to.

In any case, the Government's unsupported statement that the only excess-profits tax imposed for 1944 was the tax finally determined is demonstrably incorrect, as shown in our main brief (p. 45 *et seq.*). For example, the very section of law (Section 710 of the Code)—entitled "*Imposition of Tax*"—levying the excess-profits tax provides that the tax "imposed" is the tax "levied, collected, and paid." The tax levied, collected, and paid in this case is, of course, the tax initially determined (before carry-back) by the taxpayer on its return, not the tax finally determined by the Commissioner. Other illustrations of this same usage are set forth in our main brief. And even if the meaning of the word "imposed" were equivocal in that respect, the tax imposed *accrued within the taxable year* can only be the tax initially imposed, not that determined in a *later taxable year*.

The Government ignores all this. It merely says that "It seems inconceivable that Congress proposed that this adjustment should be made without regard to the known and established facts relating to the liability for the earlier period" (1944). (Br. p. 33.) Far from being inconceivable, that is exactly what Congress did in Section 122 (b)(1). It provided in terms under Section 122 (b)(1)(B) that the *net income* for the second preceding taxable year (1944 in this case) shall be computed without regard to the net operating loss for the taxable year (1946). In other words, in making the computation under Section 122 (b)(1), the subsequently established fact of a net operating loss is specifically excluded from consideration.

Indeed, the legislative history of Section 122 (d)(6) shows that what the Government regards as "inconceivable" was specifically and deliberately provided for by Congress. As noted in our main brief (p. 31), Section 122 (d)(6) was copied virtually verbatim from Section 23 (c)(2) of the Code, as amended by the Revenue Act of

1941. (Main Brief, Appendix A, pp. 63-64.) That section provided for a deduction for taxes paid or accrued within the taxable year subject to four limiting rules—Rules (A), (B), (C) and (D)—for that deduction "in the case of the excess-profits tax imposed by Subchapter E of Chapter 2." Rules (B), (C) and (D) were incorporated word for word as Rules (A), (B) and (C) of Section 122 (d)(6). Old Rule (A) was omitted from Section 122 (d)(6). That rule provided that

> "in the case of *the excess-profits tax imposed by Subchapter E of Chapter 2*—
>
> "(A) The deduction shall be limited to the *tax imposed* for the taxable year * * *." (Italics supplied.)

Congress incorporated practically verbatim in Section 122 (d)(6) the italicized identifying language preceding Rule (A) but deliberately omitted that rule from Section 122 (d)(6). Old Rule (A) would have limited the (d)(6) adjustment to the "tax imposed." The Government asks that this Court write old Rule (A) into Section 122 (d)(6) despite the fact that the Congress deliberately refused to do so.

Finally, the Government urges that "the plain purpose of the net operating loss provisions is to effect an exception to the annual period for tax accounting and to substitute a five-year unit", that is the loss year plus the two preceding and two following years. (Br. p. 37 and footnote 26.) This statement will not stand analysis. Of course, Congress permitted carry-forward and carry-back of losses, but it specifically provided for the measurement of such losses by reference to the annual accounting period. In particular, Section 122 (d)(6) provides for a deduction for the tax "paid or accrued *within the taxable year.*" The very use of the phrase "accrued within the taxable year" in the section in controversy necessarily embodies the annual accounting principle; if events after the taxable year are taken into account, the word "accrued" is read out of the statute. Indeed, a deviation from the annual accounting

principle here would, as the Government admits (Br. p. 38), make the Section 122 (d)(6) adjustment under Section 122 (b)(1) futile for all practical purposes so far as accrual basis taxpayers are concerned. (Petitioner's Main Brief, p. 49 *et seq.*)

Paradoxically enough, the foundation of the Government's argument on Point 1 depends on the annual accounting principle. Thus, it attempts in Point 1 to demonstrate that accrual basis taxpayers will occasionally have a (d)(6) adjustment under Section 122 (a) by citing the case of a contested tax liability settled and hence accrued in a loss year. (*Olympic Radio* Brief, No. 10, p. 18.) For example, a contested 1944 tax liability settled in 1946 (a loss year) could be accrued in 1946 and added to a taxpayer's 1946 net operating loss. But if the annual accounting principle does not apply under Section 122, such tax should be treated as a 1944 item, rather than, as the Government contends under Point 1, a 1946 item. Having adopted the annual accounting principle as a basic premise of its argument under Point 1, the Government is hardly in a position to disclaim its application under Point 2.

The Government seems to deem it significant (Br. pp. 35-36) that the tax accrued by taxpayer for 1944 was subsequently refunded to taxpayer in part as a result of reduction of its income through renegotiation in a later year.[8]

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[8] The Government states (Br. p. 34) that the tax finally determined for 1944 was the amount determined after some thirteen "corrections." The great dollar bulk of the "corrections" involve events such as renegotiation and a net operating loss deduction *arising out of events occurring in later years.* The other "correcrections" involve the usual adjustments arising on audit of a return. Acceptance of the Government's implication that these latter corrections—which the Government terms "errors"—should be taken into account in determining the tax accrued in 1944, could only be favorable to taxpayer since the tax accrued for that year will thereby be increased over the $625,561.59 figure claimed by the taxpayer. This is true because the balance of such "errors" resulted in increasing the taxpayer's income over that reported on the return. (R. 4.) The point is actually academic on the facts here involved since any increase in taxpayer's accrued income for 1944 over $584,866.81 will not affect the ultimate result.

But the Government makes no mention of the established rule under the annual accounting system (Petitioner's Brief, p. 38, footnote 33) that the tax accrued in a taxable year is the tax on the income of that year before adjustment for renegotiation occurring in a later year. The basis of this and other holdings under the annual accounting rule has been aptly set forth by the Commissioner (Mim. 6444, C. B. 1949-2, p. 11, at 12):

> "Since the decision in *Burnet* v. *Sanford & Brooks Co.* (282 U. S. 359 * * * (1931)), emphasis has been given to the point that income taxation is on an annual basis. So long as an item of income or expense was properly accounted for in one period, no change is justified under this doctrine merely because events in a subsequent period might materially change the treatment of the original item. The opinion of the Supreme Court of the United States in *Security Flour Mills Co.* v. *Commissioner* (321 U. S. 281 * * * (1944)), reiterated this doctrine."[9]

Acceptance of the Government's argument that use of the word "imposed" in Section 122 (d)(6) provides a basis for abandonment of the annual accounting system would have far-reaching and startling implications. As earlier noted, a cardinal principle under the annual accounting system is that a deduction for taxes accrued under Section 23 (c) of the Code is taken upon the basis of the facts existing at the end of the taxable year even though the tax may subsequently be refunded. (Petitioner's Main Brief, p. 38 *et seq.*) The Commissioner's implementing regulations under Section 23 (c) use the word "imposed" in exactly the same sense as in Section 122 (d)(6), stating that taxes *imposed* by specified laws are deductible when paid or accrued. (Petitioner's Main Brief, p. 43.) Acceptance of the Government's argument as to the meaning of the word "imposed" would therefore

---

[9] The annual accounting principle has recently been applied by this Court in *Healy* v *Commissioner*, 345 U. S. 278 (1953).

overturn the established rule that taxes may be deducted in the year accrued despite the fact they are subsequently refunded. The effect of the Government's argument is that this settled rule should be reversed.

C. The Government in Substance Confesses That the Court Below Erred in Applying the "Matching Principle" Upon Which Its Decision Was Based.

The Government urges that "taxpayer's theory suffers * * * from a glaring internal inconsistency." (Br. pp. 34-36.) This is said to arise because taxpayer under Section 122 (b)(1) reduces the finally determined 1944 net income—stated by the Government to be $584,866.81 (Br. 35)—by the tax originally accrued for 1944—$625,561.59. The Government states that the tax accrued figure must be deducted from the figure "*on the basis of which the * * * tax was computed.*" This is the "matching" principle which the court below relied on. As shown in detail in our main brief (pp. 34-37), the "matching" principle is nowhere expressed by Congress and is specifically negatived by the conceded meaning of Section 122 (b)(1) in other situations. The Government does not meet this point in any way.

But if it be assumed, *arguendo,* that the guiding principle under Section 122 (b)(1) is that the Section 122 (d)(6) adjustment must be deducted from (matched against) the figure "*on the basis of which the * * * tax was computed*", then the Government has confessed that the decision of the court below was in error. The court below held (R. 72) the Section 122 (d)(6) adjustment to be $280,540.33—the tax finally determined for 1944 on income *after* carry-back—and subtracted this adjustment from $584,866.81, the 1944 income *before* carry-back. The tax of $280,540.33 was not computed upon the basis of the figure from which it was subtracted by the court below. It was computed on the basis of the 1944 income after carry-back—$420,540.43. (R. 4, 9; Petitioner's Main Brief p. 36; Respondent's Brief

p. 35, footnote 24.) It is therefore evident that the Section 122 (d)(6) adjustment to 1944 net income *before* carry-back ($584,866.81) found by the court below—namely, the tax ($280,540.33) on income *after* carry-back—is incorrect even on the matching theory adopted by the court below and urged here by the Government.

In falling into this error, the court was doubtless influenced by an erroneous statement inadvertently made by the Government in its brief below. In that brief (p. 41), the Government claimed that taxpayer was inconsistently contending that the tax accrued figure for 1944 ($625,561.59) should be subtracted "from the much lesser *net income ($584,866.81) upon which the 1944 excess-profits tax of $280,540.33, as finally imposed, was computed.*" Although the Government now recognizes in a footnote (p. 35, footnote 24) that the tax figure of $280,540.33 was actually computed upon 1944 net income of *$420,540.43*, it quotes with approval (p. 35) language of the Court of Appeals embodying this error. Thus it cites (p. 35) the erroneous reference by the Court of Appeals to the "1944 income as finally determined ($584,866.81)." Indeed, the Government repeats in the text of its brief in this Court (pp. 34-35) the same error that the corrected (finally determined) net income for 1944 was $584,866.81.

CONCLUSION

Taxpayer respectfully submits (Question 1) that the proper amount of the Section 122 (d)(6) adjustment under Section 122 (a) is the tax "paid" within the taxable year, and (Question 2) that the proper amount of the Section 122 (d)(6) adjustment under Section 122 (b) is either (a) if taxpayer prevails on Question 1, the tax "paid" within the taxable year, or (b) if the Government prevails on Question 1, the tax "accrued" or determined on the basis of facts existing at the end of the taxable year and not the tax ultimately determined after taking into account events arising in later years.

For the foregoing reasons, the judgment of the Court of Appeals should be reversed.

Respectfully submitted,

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April, 1955.

APPENDIX

EXAMPLE A (See p. 3)

This example involves the calendar years 1944 through 1947, the same years selected in the Government's Example 3 (Brief, Appendix B, p. 23a). There was no excess-profits tax in 1946 and 1947. X Corporation and Y Corporation are on the accrual basis and each has an aggregate income over the four-year period of $80,000. Assume each has an excess-profits credit for each year of $10,000.

TAXPAYER X CORPORATION

Year	Net Income	Total Tax Applying Petitioner's Contention as to Section 122(d)(6)
1944	$24,000	0
1945	(20,580)	0
1946	25,580	$ 6,057.60
1947	51,000	19,380.00
Aggregate	$80,000	$25,437.60

TAXPAYER Y CORPORATION

Year	Net Income	Total Tax
1944	$20,000	$ 5,300.00
1945	20,000	5,300.00
1946	20,000	4,500.00
1947	20,000	4,500.00
Aggregate	$80,000	$19,600.00

Computations Applicable to X Corporation

SCHEDULE 1

Computation of Income and Excess-Profits Tax for 1944 for X Corporation Applying Petitioner's Contention

1. Net income (prior to Sec. 26 (e) credit and carry-back of 1945 net operating loss)		$24,000.00
2. Less: 1945 net operating loss before 122 (d) (6) adjustment	$20,580.00	
1944 excess-profits tax paid in 1945—(d)(6) adjustment (Item 17 below)	3,420.00	
1945 net operating loss		24,000.00
3. Normal tax and surtax net income		0
4. Income tax		0
5. Excess-profits tax		0

Computation of 1944 Excess-Profits Tax Paid in 1945
(Before Carry-Back of 1945 Net Operating Loss)

6. Excess-profits net income (Item 1 above)		$24,000.00
7. Less:		
Specific exemption	$10,000.00	
Excess-profits credit	10,000.00	20,000.00
8. Adjusted excess-profits net income		4,000.00
9. 95% of $4,000.00		3,800.00
10. Computation of the 80% limitation:—		
11. Surtax net income prior to Sec. 26 (e) credit and carry-back from 1945 (Item 1 above)		$24,000.00
12. 80% of $24,000.00		$19,200.00
13. Less: Chapter 1 income tax		5,300.00
14. Limitation of excess-profits tax		$13,900.00
15. Excess-profits tax for 1944 (lesser of Item 9 and Item 14)		$ 3,800.00
16. Less: Postwar credit		380.00
17. Net excess-profits tax on income before carry-back		$ 3,420.00

SCHEDULE 2

(No Tax for 1945 for X Corporation—Loss Year)

SCHEDULE 3

Computation of Income Tax for 1946 for X Corporation

1. Normal tax net income	$25,580.00
2. Normal tax on first $25,000.00	$ 4,250.00
3. Normal tax on $580.00 @ 31%	179.80
4. Surtax on $25,000.00 @ 6%	1,500.00
5. Surtax on $580.00 @ 22%	127.60
6. Income tax	$ 6,057.40

SCHEDULE 4

Computation of Income Tax for 1947 for X Corporation

1. Normal tax net income	$51,000.00
2. Normal tax @ 24%	$12,240.00
3. Surtax at 14%	7,140.00
4. Income tax	$19,380.00

Computations Applicable to Y Corporation

SCHEDULE A

Computation of Income Tax for 1944 for Y Corporation
(Same Computation for 1945)

1. Normal tax net income	$20,000.00
2. Normal tax on first $5,000.00 @ 15%	$ 750.00
3. Normal tax on next $15,000.00 @ 17%	2,550.00
4. Surtax @ 10%	2,000.00
5. Income tax	$ 5,300.00
6. Excess-profits tax (excess-profits net income of $20,000.00 (Item 1) wiped out by specific exemption of $10,000.00 and excess-profits credit of $10,000.00)	0

SCHEDULE B

Computation of Income Tax for 1946 for Y Corporation
(Same computation for 1947)

1. Normal tax net income	$20,000.00
2. Normal tax on first $5,000.00 @ 15%	$ 750.00
3. Normal tax on next $15,000.00 @ 17%	2,550.00
4. Surtax @ 6%	1,200.00
5. Income tax	$ 4,500.00

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No. 417

In the Supreme Court of the United States

OCTOBER TERM, 1954

LEWYT CORPORATION (NOW KNOWN AS LEWYT MANUFACTURING CORPORATION), PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE RESPONDENT

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MEMORANDUM FOR THE RESPONDENT

The petition in this case raises three questions. The first of these corresponds to the question which is presented in *United States* v. *Olympic Radio and Television, Inc.*, No. 10, in which this Court issued a writ of certiorari to the Court of Claims on October 14, 1954. So far as this question is concerned, the Government does not oppose the review which petitioner seeks.

The second question set forth in the petition is related to the first question and, for the reasons

indicated *infra*, pages 3-5, it seems appropriate that it be reviewed contemporaneously.

The third question, however, is unrelated to the first two. In our view, it was correctly decided by the court below, involves no question of general importance, and presents no conflict. As to this question, therefore, the Government opposes review.

We shall comment briefly upon each of the questions, treating them in the order in which they are stated in the petition.

1. The first question (which corresponds to that in No. 10) is as follows: Whether, under section 122(d)(6) of the Internal Revenue Code of 1939, a taxpayer on the accrual basis, in computing its net operating loss for a particular year, may deduct the amount of excess profits taxes paid in that year but accrued in an earlier year.[1]

Affirming the Tax Court, the court below sustained the Commissioner's contention that the alternative verbs in section 122(d)(6), "paid or accrued within the taxable year" were used to comprehend, and distinguish between, taxpayers on a cash or accrual basis (*i. e.*, "paid," if on cash basis, and "accrued," if on accrual basis), and were not designed to give an accrual-basis taxpayer the right to deduct its excess profits tax in the year paid, if

[1] The pertinent provisions of the 1939 Code, sections 23(c)(1), (s), 41, 43, 48(c), 122, and 711, are set forth in the Appendix, *infra*, pp. 8-17.

the tax accrued in another year. As previously pointed out in the Government's petition and in its supplemental memorandum in No. 10, the Court of Claims has recognized that it is in conflict with the Tax Court (see *Olympic Radio and Television, Inc.* v. *United States*, 108 F. Supp. 109, 111-112), and the court below has recognized that it is in conflict with the Court of Claims (see opinion in the instant case, Pet. 43).

2. The second question is related to the first, for it also involves an interpretation of Section 122(d)(6), though in a different context, i. e., in making the adjustments provided for in Section 122(b)(1).

The latter section states that a net operating loss for a particular taxable year (here, 1946) may be carried back for two preceding years as a deduction in computing net income. It states further that the deduction shall be applied, first, to the second preceding year (i. e., 1944) and that, if not exhausted in that year, the unused balance may be applied to reduce the income of the first preceding year (i. e., 1945). The practical problem here is how much of petitioner's 1946 net operating loss is carried back to 1945. That depends upon how much had been absorbed by 1944 net income. In determining for purposes of the adjustment contemplated by Section 122(b)(1) the quantum of petitioner's 1944 net income, one is brought back by the statute to Section 122(d)(6), for Section 122(b)(1) (*infra*, p. 11) specifically directs a

"(d)(6)" adjustment to the net income for the second preceding year.[2]

In this context, the conflicting contentions as to the meaning of Section 122(d)(6) are as follows: Petitioner claims that the amount of excess profits tax which accrued in the taxable year 1944 was the amount which it reported in its 1944 return ($625,561.59);[3] the Government contends that a lesser amount, representing the sum for which petitioner was ultimately found liable ($280,540.33), was "the tax which was 'imposed' for 1944" and "was 'the amount' of the tax which 'accrued' in 1944 for purposes of this adjustment." (Pet. 44.)

While we believe the petitioner's second question was correctly decided by the court below, the fact that it involves construction of the same and of closely related language appearing in Section 122(d)(6) suggests that review of this question would be appropriate in the event that the Court should grant review of the first question presented.

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[2] Section 122(d)(6) (*infra*, p. 14) directs that "There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 [Excess Profits] paid or accrued within the taxable year * * *."

[3] Relying on the views which it expresses in connection with the first question, petitioner also contends, in the alternative, that the amount of 1943 excess profits taxes returned for that year and paid by it in 1944 in the sum of $759,916.50 is the amount of excess profits tax which should be deducted from the 1944 income. (Pet. 4.) As the court below pointed out, either under this claim or under the claim that the deduction should be in the sum of $625,561.59, the amount of excess profits taxes would exceed the amount of the 1944 income ($584,866.81) with the result that the entire 1946 net operating loss would be carried back to 1945. (Pet. 43-44.)

We note additionally that this question, like the first question, is of recurrent importance in the administration of the tax laws.[4]

3. The third question presented by the petition is whether sums tendered the Collector in 1947 in respect of contested excess profits tax for prior years, and placed by the Collector in a suspense account, constituted a *payment* of taxes in the year 1947. The practical significance of this question in the instant case is its bearing upon the quantum of net operating loss which petitioner may claim for 1947 in computing a loss carry-back. Its disposition does not in any way depend upon the other questions presented by petitioner. Indeed, as the court below observed (Pet. 34), for purposes of this contention petitioner assumed the correctness of the Tax Court's decision on its first question.

Reviewing the pertinent events with care, the Court of Appeals found (see Pet. 32-37), as had the Tax Court before it, that no settlement concerning the disputed liabilities was reached in 1947; that, in fact, petitioner was tendering its checks with

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[4] In addition to cases before the Treasury the question has been passed upon by the Tax Court in the following cases, each presently pending in a Court of Appeals on taxpayer's appeal:

Hunter Mfg. Co. v. *Commissioner*, 21 T.C. 424, appeal pending (C.A. 3d); *W. L. Maxson Corp.* v. *Commissioner*, decided January 26, 1953 (1953 P-H T.C. Memorandum Decisions, par. 53,021), supplemental opinion June 17, 1954 (1954 P-H T.C. Memorandum Decisions, par. 54,174), appeal pending (C.A. 2d); *Byrne Doors, Inc.* v. *Commissioner*, decided April 8, 1954 (1954 P-H T.C. Memorandum Decisions, par. 54,107), appeal pending (C.A. 6th).

one hand and contesting liability with the other; and that the Collector in fact received the monies, which he placed in the suspense account, not as a satisfaction of liability, either in whole or in part, but as deposits "to abide the event of the disposition of these disputes" (Pet. 36). There is no occasion for this Court to review these concurrent findings.

The courts below were plainly correct, moreover, in holding that in the circumstances found to exist there was no legal duty on the Commissioner to accept the monies as " 'payments' *pro tanto* of the asserted or putative tax liabilities" (Pet. 35). See *Rosenman* v. *United States*, 323 U. S. 658;[5] *Roles* v. *Earle*, 195 F. 2d 346 (C. A. 9th), certiorari denied, 344 U. S. 819; *Thomas* v. *Mercantile Nat. Bank at Dallas*, 204 F. 2d 943 (C. A. 5th); *Standard Brewing Co.* v. *Commissioner*, 6 B. T. A. 980, 983. Contrary to taxpayer's suggestion (Pet. 12-15), the decision below is nowise inconsistent with *McConkey* v. *Commissioner*, 199 F. 2d 892 (C. A. 4th), certiorari denied, 345 U. S. 924, nor with the Second Circuit's decision in *Bendheim* v. *Commissioner*, 214 F. 2d 26. In both of these cases, as Judge Harlan pointed out (Pet. 46), the Commissioner stated a proposed deficiency not in excess of the deposit, thereby unequivocally indicating an acceptance of the taxpayer's offer. *Standard Portland Cement Co.* v. *Commissioner*, 80 F. 2d 585

[5] While petitioner claims support from *Rosenman* (Pet. 19-21), as the Court of Appeals' opinion fully demonstrates (Pet. 36-37), that decision supports the result reached here.

(C. A. 3d), with which petitioner also claims a conflict (Pet. 13), is plainly not in point for there the taxpayer made the payment unconditionally.[6]

CONCLUSION

The Government does not oppose the grant of certiorari but urges that, if the writ is issued, it be limited to the first two questions raised by the petition.

Respectfully submitted,

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NOVEMBER, 1954.

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[6] Petitioner also states (Pet. 2, fn.) that, in connection with one of the remittances involved, it intends to urge, if certiorari is granted, that such remittance constituted a "payment" of tax under the doctrine of collateral estoppel. This contention, which likewise depends basically upon factual determinations, was summarily overruled by the Court of Appeals (Pet. 38; see, also, R. 60, 134-136).

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) [As amended by Sec. 202(a) of the Revenue Act of 1941, c. 412, 55 Stat. 687] *Taxes Generally.*—

(1) *Allowance In General.*—Taxes paid or accrued within the taxable year, except—

(A) Federal income taxes;

(B) [As amended by Sec. 105 (c) (1) of the Revenue Act of 1942, c. 619, 56 Stat. 798] war-profits and excess-profits taxes imposed by Title II of the Revenue Act of 1917, Title III of the Revenue Act of 1918, Title III of the Revenue Act of 1921, section 216 of the National Industrial Recovery Act, section 702 of the Revenue Act of 1934, or Subchapter E of Chapter 2, or by any such provisions as amended or supplemented;

* * * * *

(s) [As added by Sec. 211 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the

net operating loss deduction computed under section 122.

* * * * *

(26 U. S. C. 1952 ed., Sec. 23.)

PART IV—ACCOUNTING PERIODS AND METHODS OF ACCOUNTING

SEC. 41—GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the corporation dividends paid credit provided in

section 27) provided for in this chapter shall be taken for the taxable year in which "paid or accrued" or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

(26 U. S. C. 1952 ed., Sec. 43.)

SEC. 48. DEFINITIONS.

When used in this chapter—

* * * * *

(c) *"Paid or Incurred," "Paid or Accrued."*—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * * * *

(26 U. S. C. 1952 ed., Sec. 48.)

SEC. 122. [As added by Sec. 211 (b) of the Revenue Act of 1939, *supra*]. NET OPERATING LOSS DEDUCTION.

(a) [As amended by Sec. 105 (e) (3) (A) of the Revenue Act of 1942, *supra*]. *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over

the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [As amended by Sec. 153(a) of the Revenue Act of 1942, *supra*] *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

(2) *Net operating loss carry-over.*—If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such net operating

loss over the net income for the intervening taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss and without regard to any net operating loss carry-back. For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941 shall be reduced by the sum of the net income for each of the two preceding taxable years (computed for each such preceding taxable year with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and computed by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year).

(c) [As amended by Secs. 105(c)(3)(B) and 153(b) of the Revenue Act of 1942, *supra*] *Amount of Net Operating Loss Deduction.*— The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d)(1), (2), (3), and (4))

exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credit provided in section 26(e));

(d) [As amended by Sec. 105(e)(3)(C) of the Revenue Act of 1942, *supra*] *Exceptions, Additions, and Limitations.*—The exceptions, additions, and limitations referred to in subsections (a), (b), and (c) shall be as follows:

(1) The deduction for depletion shall not exceed the amount which would be allowable if computed without reference to discovery value or to percentage depletion under section 114(b)(2), (3), or (4);

(2) There shall be included in computing gross income the amount of interest received which is wholly exempt from the taxes imposed by this chapter, decreased by the amount of interest paid or accrued which is not allowed as a deduction by section 23(b), relating to interest on indebtedness incurred or continued to purchase or carry certain tax-exempt obligations;

(3) No net operating loss deduction shall be allowed;

(4) [As amended by Sec. 150(e) of the Revenue Act of 1942, *supra*] Gains and losses from sales or exchanges of capital assets shall be taken into account without

regard to the provisions of section 117(b). As so computed the amount deductible on account of such losses shall not exceed the amount includible on account of such gains;

(5) Deductions otherwise allowed by law not attributable to the operation of a trade or business regularly carried on by the taxpayer shall (in the case of a taxpayer other than a corporation) be allowed only to the extent of the amount of the gross income not derived from such trade or business. For the purposes of this paragraph deductions and gross income shall be computed with the exceptions and limitations specified in paragraphs (1) to (4) of this subsection.

(6) There shall be allowed as a deduction the amount of tax imposed by Subchapter E of Chapter 2 paid or accrued within the taxable year, subject to the following rules—

(A) No reduction in such tax shall be made by reason of the credit for income, war-profits, or excess-profits taxes paid to any foreign country or possession of the United States;

(B) Such tax shall be computed without regard to the adjustments provided in section 734; and

(C) Such tax, in the case of a consolidated return for excess-profits tax purposes, shall be allocated to the members

of the affiliated group under regulations prescribed by the Commissioner, with the approval of the Secretary.

* * * * *

(26 U.S.C. 1952 ed., Sec. 122.)

SEC. 711 [as added by Sec. 201 of the Second Revenue Act of 1940, c. 757, 54 Stat. 974]. EXCESS PROFITS NET INCOME.

(a) *Taxable Years Beginning After December 31, 1939.*—The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13(a)(2), for such year except that the following adjustments shall be made:

(1) *Excess profits credit computed under income credit.*—If the excess profits credit is computed under section 713, the adjustments will be as follows:

* * * * *

(J) [as added by Sec. 210(a) of the Revenue Act of 1942, *supra*] *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122(a), and the net income for any tax-

able year under section 122(b), no deduction shall be allowed for any excess profits tax imposed by this subchapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall be reduced by the amount of any reduction under paragraph (2) (B) for such taxable year; * * *

* * * * *

(2) *Excess profits credit computed under invested capital credit.*—If the excess profits credit is computed under section 714, the adjustments shall be as follows:

* * * * *

(L) [as added by Sec. 210(b) of the Revenue Act of 1942, *supra*] *Net Operating Loss Deduction Adjustment.*—The net operating loss deduction shall be adjusted as follows:

(i) In computing the net operating loss for any taxable year under section 122(a), and the net income for any taxable year under section 122(b), no deduction shall be allowed for any excess profits tax imposed by this sub-chapter, and, if the excess profits credit for such taxable year was computed under section 714, the deduction for interest shall

be reduced by the amount of any reduction under sub-paragraph (B) of this paragraph for such taxable year: * * *

* * * * *

(26 U.S.C. 1952 ed., Sec. 711.)

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No. 417

In the Supreme Court of the United States

OCTOBER TERM, 1954

LEWYT CORPORATION (NOW KNOWN AS LEWYT MANUFACTURING CORPORATION), PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Court of Appeals (R. 57-73) is reported in 215 F. 2d 518. The opinion of the Tax Court (R. 23-36), rendered *en banc*, is reported in 18 T. C. 1245.

JURISDICTION

The judgment of the Court of Appeals was entered on July 14, 1954. (R. 74.) Taxpayer's petition for rehearing was denied on August 24, 1954.

(R. 75.) The petition for a writ of certiorari was filed on October 20, 1954, and granted on December 6, 1954, limited to Questions 1 and 2 presented by the application for the writ. (R. 75-76.) The jurisdiction of this Court rests upon 28 U.S.C., Section 1254.

QUESTIONS PRESENTED

1. Whether, under Section 122(d)(6) of the Internal Revenue Code, a taxpayer on the accrual basis can, in computing its net operating loss for one year, deduct the amount of excess profits taxes which were paid in that year but had accrued in an earlier year.

2. Whether under Section 122(d)(6), as incorporated by reference in Section 122(b)(1), "the amount of tax imposed by Subchapter E of Chapter 2 [the excess profits tax] paid or accrued within the taxable year" is the amount taxpayer originally reported on its return for excess profits tax or the sum ultimately found to be due for that year.

STATUTE AND REGULATIONS INVOLVED

The pertinent statutory provisions (Sections 23(c)(1) and (s), 41, 43, 48(c), 122, 710(a)(1) and (b), 711(a)(1)(J) and (2)(L) of the Internal Revenue Code of 1939[1] and Treasury Regulations (Treasury Regulations 111, Sections 29.41-1, 29.41-2, 29.43-1, 29.122-1, and 29.122-2) are the same as those set forth in the brief for the United States in the companion case of *United States* v. *Olympic*

[1] All references to the "Internal Revenue Code" or "Code" are to the "Internal Revenue Code of 1939" unless otherwise expressly noted.

Radio and Television, Inc., No. 10, Appendix A, pp. 36-53, with the exception of Treasury Regulations 111, Sections 29.122-4 and 29.122-5, set forth in Appendix A, *infra*, pp. 1a-11a.

STATEMENT

The facts relevant to the two questions presented for review are not in dispute. They may be summarized as follows:

Taxpayer is a New York corporation engaged in the manufacture of vacuum cleaners and electronic devices. It maintained its books and records and filed its tax returns on the accrual method of accounting, using a fiscal year ending September 30th.[2] (R. 24, 37-38, 57.)

The years 1944 and 1945 were profit years for taxpayer, and were followed by loss years in 1946 and 1947. In this Court, the controversy is limited to (a) the proper computation of the net operating loss for 1946, and (b) the proper application of the net operating losses for 1946 and 1947 as carrybacks to the income of the profit years 1944 and 1945.

Taxpayer's 1943 return stated an excess profits tax liability of $759,916.50. It paid that amount in 1944. (R. 24, 70.) Its ultimate liability, however, was fixed at $140,147.87. (R. 26, 61.)

The excess profits tax for 1944 originally reported by taxpayer on its return was $325,561.59 (R. 40A, 70-71). In 1945, it paid $510,939.23 on

[2] Taxpayer's fiscal years will be referred to by the calendar year in which each ended.

account of its 1944 excess profits tax (R. 24). The excess profits tax for 1944 ultimately found by the Commissioner to be due was $280,540.33 (R. 9, 24, 71). Net income for the same year was found to be $420,540.43 (R. 4, 24).

The excess profits tax for 1945 originally reported by taxpayer on its return was $861,118.04 (R. 25, 56A). This sum was paid by taxpayer in 1946 (R. 25, 66). The excess profits tax for 1945, as found by the Commissioner, was $192,810.61 (R. 2, 17). Net income for the same year was found to be $282,869.25[3] (R. 11).

For the years 1946 and 1947, taxpayer incurred net operating losses of $164,326.38 and $786,383.25, respectively. (R. 24.) Net operating losses in these amounts were allowed by the Commissioner as carry-back deductions to the years 1944 and 1945. (R. 4, 11, 24-25.)

Taxpayer's basic position (Taxpayer's Br., Point I) is that, under Section 122(d)(6), it is entitled to augment its 1946 net operating loss ($164,326.38) by the amount of excess profits taxes which it paid in 1946 ($861,118.04) on account of its 1945 excess profits tax liability. Under this view, the 1946 net operating loss available for carry-back purposes would be increased to $1,025,444 (*id.*, pp.

[3] Before the Tax Court, the Commissioner alleged that he had improperly allowed a $55,949.04 interest deduction for 1947. Disallowance of this deduction by the Tax Court (a matter not here in dispute) increased from $192,810.61 to $231,079.75 the excess profits tax for 1945. Correspondingly, it increased from $428,288.05 to $466,557.19 the deficiency for that year claimed by the Commissioner. (R. 23-24, 36-37.)

3-4; R. 60-66). It is the Commissioner's position that since taxpayer is on the accrual basis the excess profits tax liability which accrued in 1945 is not available for purposes of 1946 tax computations.

Taxpayer's second contention relates to the proper application of a 1946 net operating loss carry-back to the two preceding years. Under the statutory formula (see Section 122(b)(1), incorporating Section 122(d)(6) by reference), this requires a preliminary adjustment to taxpayer's 1944 net income. See Court of Appeals' opinion at R. 70-72 and discussion, *infra*, pages 25-31. Making this adjustment to 1944 net income involves, in part, the same type of question presented by taxpayer's first contention, *i.e.*, whether there is to be offset, as against 1944 net income, excess profits taxes paid in 1944 on account of the liability incurred for the previous year (taxpayer's position) *or* the excess profits tax liability accrued in 1944 (the Commissioner's position).[4] It also involves, however, a distinct question: Whether the excess profits tax to be offset against 1944 net income is the amount of excess profits tax *reported* for the year in question (as taxpayer contends) or the amount *ultimately found to be due* (as the Commissioner contends).[5]

[4] As to this aspect, the Court's holding on Question 1 will be dispositive.

[5] The practical significance of the dispute as to the proper deduction from 1944 net income is its effect, under the statutory formula, upon the amount of carry-back, if any, available

The Tax Court, sitting *en banc*, unanimously sustained the Commissioner's position on Questions 1 and 2 as here presented (R. 29-36), and assessed deficiencies accordingly (R. 36-37). The Court of Appeals (Clark, Hincks, and Harlan, JJ.) unanimously affirmed (R. 57-73) and denied taxpayer's petition for rehearing (R. 75).

SUMMARY OF ARGUMENT

If taxpayer prevails on both of its contentions in this case, it will be enabled to exploit actual operating losses of $950,709.63 (suffered in the loss years 1946 and 1947) so as to offset entirely total net income for 1944 and 1945 aggregating $1,654,119.31. Moreover, under its theories, it will still have available as a carry-over against potential income accruing in 1948 and 1949 an additional amount of more than $1,000,000.

Taxpayer's theory as to Question 2, standing alone, leads to the conclusion, no less extraordinary, that a 1946 net operating loss may be applied as an offset to net income earned in the second preceding year (1944) and still be available, undiminished in amount, for application against the income of the first preceding year (1945).

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not offset against 1945 net income. Note that, under Section 122(b)(1)(C), a net operating loss carry-back there, the 1946 loss must first be applied to the second preceding year (*i.e.*, 1944). Taxpayer would view the excess profits tax "imposed" as the amount it reported (rather than the lesser amount ultimately found to be due), because that would have the effect of minimizing 1944 net income and, by the same token, would maximize carry-back available for 1945.

The statute does not invite or compel these bizarre results. Fairly read, it precludes them.

I

The Code permits a taxpayer, in computing a net operating loss as defined in Section 122(a), to take into account, pursuant to Section 122(d)(6), excess profits taxes "paid or accrued" in the taxable year. Although this taxpayer is on the accrual basis, it would augment its operating loss for 1946 by the excess profits taxes accrued in 1945 and paid in 1946. This contention is the same as the one made by taxpayer in *United States* v. *Olympic Radio and Television, Inc.*, No. 10.

As fully set forth in our brief in No. 10, we believe that the issue is controlled by the explicit Code definition which declares that the "terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed . . ." (Section 48(e)). We have also pointed out in the Government's *Olympic* brief that Section 122(d)(6) was regarded by Congress as a "technical" amendment made necessary by contemporaneous revision of the excess profits tax law; that the legislative history of this particular subsection is obscure and inconclusive; and that, in sum, this history does no more than confirm the wisdom of confining the subsection within the limits imposed by its statutorily defined terminology. We do not elaborate these arguments here.

While taxpayer claims that the holding of the Court of Appeals is inequitable, it fails to show that its actual losses in 1946 and 1947 were given anything less than their full effect in the Commissioner's computation of carry-back available for application to 1944 and 1945. The basis of complaint is that only occasionally will the "(d)(6)" adjustment provide an additional benefit to an accrual basis taxpayer. Many tax provisions are apt to have a differing incidence depending upon the method of accounting chosen by the taxpayer. Moreover, while taxpayer asserts that Section 122 (d)(6), as construed below, favors cash basis taxpayers (which are few in number among corporations), it ignores the fact that its contention, if accepted, would cause widespread discrimination in large amounts in favor of corporate taxpayers having fluctuating income as opposed to those having relatively stable earnings. The net operating loss deduction provided by Congress was designed to relieve the taxpayer with fluctuating profit and loss years from unjust burdens. There is no basis for supposing that the corporation with fluctuating profit and loss years, but enjoying over-all profits, was to be equipped with a device for avoiding the imposition of taxes on its over-all profits and thereby placed in a special, privileged class.

The line of cases exemplified by *Commissioner* v. *Clarion Oil Co.*, 148 F. 2d 671 (C.A.D.C.), certiorari denied, 325 U.S. 881, was properly distinguished below. Those cases involved the penalty

tax on undistributed income of personal holding companies and rest on the rationale that a company is not to be penalized "for not distributing as dividends money which it either does not have, because it pays it out in back taxes during the year, or which prudence would require it to keep, because it will be needed to pay taxes accrued during the year though not payable until the following year . . ." (dissenting opinion of Judge Madden in the *Olympic* case, No. 10, R. 14). Indeed, the *Clarion Oil* decision itself emphasized (148 F. 2d at 676) that, in computing the penalty tax on undistributed income, "[t]here is absent the administrative need for uniformity which exists for the computation of net income." The determination of a net operating loss deduction is, of course, an integral part of the computation of net income. If one factor in calculation of loss is computed on the cash basis and other calculations of profit and loss are computed on the accrual basis, the necessary effect is to distort net income. Even without an explicit statutory definition, one would hardly ascribe to Congress the purpose of authorizing a single taxpayer to adopt internally inconsistent methods of computing profit and loss factors. Section 48(e) in terms forbids that practice.

Taxpayer also seeks support from provisions of the Code relating to the surtax (in the nature of a penalty) upon corporations improperly accumulating surplus. Examination of these provisions shows that they are irrelevant to the issue at hand.

II

A. The answer to Question 1 bears on the quantum of taxpayer's net operating loss for 1946. A net operating loss, once determined, may be utilized as a two-year carry-back or carry-over. Section 122(b). The remaining considerations in this case relate to application of the 1946 loss carry-back.

Under Section 122 (b) (1), a net operating loss for a given year (here, 1946) shall first be carried back and deducted from the net income of the second preceding year (1944). The section then provides in substance that the amount of carry-back available for application to the first preceding year (1945) shall be the excess of the 1946 net operating loss over a figure for 1944 net income adjusted in accordance with Section 122(d)(6). It is taxpayer's position that, in applying the carry-back to 1945 and in determining for that purpose the excess of the 1946 net operating loss over 1944 net income, it may deduct from 1944 net income either—

(a) the sum representing excess profits taxes *reported* for 1943 and paid in 1944, *or*
(b) the amount representing excess profits taxes *reported* for 1944.

The suggestion embraced in (a) that 1944 net income shall be adjusted on the basis of excess profits taxes which accrued in 1943 is the same contention made by taxpayer under Point I (though made here in relation to 1944 income). Since the mean-

ing of "paid or accrued," as used in Section 122 (d)(6), must, concededly, be the same whether a "(d)(6)" adjustment is being made to 1946 net loss (pursuant to Section 122(a)) or to 1944 net income (pursuant to Section 122(b)(1)), this presents no new legal issue. The holding under Point I will be dispositive.

However, a further, distinct issue is involved in taxpayer's contentions as set forth in propositions (a) and (b) above. Taxpayer is suggesting that the amount of excess profits tax to be deducted from 1944 net income is the amount *reported* rather than the amount *ultimately found to be due.* The practical consequence of this suggestion would be to make available for application to 1945 the entire amount of the 1946 net operating loss, notwithstanding its prior application in reduction of taxpayer's 1944 tax liabilities.

B. In 1944, taxpayer reported excess profits taxes more than double the amount ultimately found to be due. To the extent that the liability reported exceeded the liability as finally determined, the excess was refunded or credited. Nonetheless, taxpayer would treat the entire *reported* tax (including the major share which it has already gotten back once) as diminishing its 1944 net income and increasing, *pro tanto*, the figure to be used in computing the amount of carry-back remaining to it for application against 1945 net income. This position is untenable.

The Congressional purpose in authorizing a carry-back is plain. The law says in effect that,

when a loss year follows years of profit, there shall be a readjustment of tax liability for the earlier period in the light of the later event. It seems inconceivable that Congress proposed that this adjustment should be made without regard to the known and established facts relating to the liability for the earlier period. A law designed to provide relief retrospectively is scarcely to be read as conferring a double benefit.

The words of Section 122(d)(6) also stand in taxpayer's path. That provision allows as a deduction "the amount of [excess profits] tax imposed." There were not two excess profits taxes imposed for 1944, but only one, and that one was the amount as finally determined.

Taxpayer's theory, moreover, is internally inconsistent. It would deduct from 1944 net income a sum representing its uncorrected excess profits tax for 1944. But it does not suggest that this amount of reported tax be deducted from the uncorrected income figure on the basis of which it was computed. In the words of the Court of Appeals, taxpayer "is seeking . . . to have the benefit of both the *smaller* 1944 income as finally determined . . . and the *larger* excess profits tax . . . based upon the income as originally reported. . . . It cannot have it both ways at the same time . . ." (R. 71)

The effect of the decision below is that the net operating loss for 1946 (found, as a result of the holding under Question 1, to be $164,326.38) is applied in full against taxpayer's 1944 net income for purposes of determining taxpayer's 1944 tax liabilities.

The holding (Question 2) does not permit this sum to be applied a second time for purposes of reducing taxpayer's liabilities for 1945. The scheme of the carry-back and carry-over provisions, which contemplate a *de novo* determination (cf. *Manning* v. *Seeley Tube & Box Co.*, 338 U.S. 561, 567), and the language of Section 122(d)(6) alike support this result. Common sense is offended by the contrary suggestion that the internal revenue laws should be interpreted to permit full application of the carry-back in 1944 and its renewed application, in 1945, undiminished in amount.

ARGUMENT

Introduction

Before turning to the legal issues, we shall briefly indicate, by reference to the pertinent facts and figures, the practical consequences which result if one accepts taxpayer's position on the two issues stated above.

Putting aside carry-backs, taxpayer's net income for 1944 was $584,866.81, and its net income for 1945, $1,069,252.50. Total net income for the two years (excluding carry-backs) is thus $1,654,119.31.[6] In 1946, taxpayer had a net loss from its operations of $164,326.38. In 1947, its net loss from operations was $786,383.25. The total loss for these two years, $950,709.63, was recognized

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[6] Net income for 1944, $420,540.43, plus 1946 net operating loss carry-back $164,326.38, equals $584,866.81. (R. 4.) Net income for 1945, $282,869.25, plus 1947 net operating loss carry-back $786,383.25, equals $1,069,252.50. (R. 11.)

by the Commissioner as available for carry-back purposes.

Subtracting the $950,709.63 of net losses for 1946 and 1947 from the $1,654,119.31 of net income for 1944 and 1945, the Commissioner has found a difference of $703,409.68, representing an aggregate balance of income for 1944 and 1945. To this should be added an item of $55,949 originally improperly allowed by the Commissioner as a deduction (see fn. 3, p. 4, *supra*). With certain minor adjustments not here material, this results in approximately $750,000 taxable income. This income the Commissioner claimed and the courts below found to be subject to a total of $567,650.91 income and excess profits taxes.[7]

Taxpayer, while not disputing that the actual losses from operations in 1946 and 1947 aggregated only the sum of $950,709 63 (R. 38), nonetheless contends that it is entitled to statutory net operating loss carry-backs from those years sufficient to offset entirely the total $1,654,119.31 of net income for 1944 and 1945. It asserts, in short, that it is subject to no federal income or excess profits taxes whatsoever for those years. Additionally, its position, if sustained, would mean that it would have available a net operating loss carry-over from 1946 and 1947 to 1948 and 1949 of more than $1,000,000. See pages 26-30; Appendix B, Example 4, p. 28a, *infra*.

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[7] The total tax liability of $529,381.77 set forth in the deficiency notice (R. 2) was corrected to the figure stated in the text as a result of the Tax Court's action in correcting the Commissioner's understatement of the 1945 deficiency. See fn. 3, p. 4, *supra*.

In contrast, a corporation receiving for the same four-year period the same aggregate income (approximately $750,000), but earning a *pro rata* share each of the years in question, would be liable for excess profits and income taxes amounting to approximately $427,000.[8] It, of course, would have no carry-over available for subsequent years.

The anomaly of supposing with taxpayer that actual operating losses amounting to $950,709.63 may be used to offset more than $2,600,000 of actual or potential income (total income for 1944 and 1945 plus amount of carry-over against potential income accruing in 1948 and 1949) immediately suggests that petitioner is claiming for the tax laws a result which Congress could scarcely have contemplated —especially so, in light of the revenue-raising purposes of the wartime excess profits legislation.

Yet, incongruously, in advancing its main contention (that, in computing a net operating loss, an accrual basis taxpayer may take into account excess profits taxes paid in the loss year which accrued in the prior year), taxpayer urges that the intention to allow the extraordinary deductions which it seeks should be ascribed to Congress in order to prevent alleged inequities, and that this Court should therefore depart from an explicit statutory definition which, in terms, requires a result adverse to taxpayer.

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[8] See computations in Appendix B, Example 1, *infra*, pp. 12a-17a.

I

The Code Does Not Permit An Accrual Basis Taxpayer, Computing A Net Operating Loss for 1946, to Deduct Excess Profits Taxes Paid in 1946 Which Had Accrued in 1945.

In computing a net operating loss, as defined in Section 122(a) of the Code, a taxpayer may take into account, pursuant to Section 122(d)(6), the amount of excess profits taxes "paid or accrued" in the taxable year. Taxpayer contends that, in computing its net operating loss for 1946, it may include the excess profits taxes which it paid in 1946 on account of its 1945 excess profits tax liability, notwithstanding the fact that it is an accrual basis taxpayer. This is precisely the same position as is taken by the taxpayer in the companion case of *United States* v. *Olympic Radio and Television, Inc.*, No. 10.

In our brief in No. 10, we have fully set forth our reasons for believing that this issue is controlled by the explicit statutory definition which declares that the "terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed . . ." (Section 48(c)). See brief in No. 10, pages 11-20. We have also pointed out in that brief (pp. 22-34) that the legislative history of Section 122(d)(6) is at best inconclusive and that, far from supporting the view that the section should be construed without regard to the statutory definition of "paid or accrued," it serves to emphasize the wisdom of confining that section within the

limits imposed by its statutorily defined terminology. Instead of repeating these arguments *in extenso* here, we respectfully refer the Court to the cited portions of our brief in No. 10. The remaining portion of this Point I will be devoted to the criticisms of the Government's position which are advanced in taxpayer's brief.

1. Taxpayer argues repeatedly in its brief that, by applying the statutory definition of "paid or accrued," the Court of Appeals has caused an inequitable result. It fails to show, however, that any actual or economic loss suffered by it in its operations has been denied effect in the Commissioner's computation of its net operating loss deductions.

Moreover, as observed above (pp. 13-15), the over-all result which taxpayer seeks in this case would exempt it from all taxes for a four-year period during which it enjoyed aggregate net profits of approximately $750,000 and would enable it to claim, in addition, very substantial carry-overs (over $1,000,000) as against potential income of subsequent years. This analysis of taxpayer's claims takes into account its contentions on the two issues raised by this case. We have accordingly set forth in Appendix B, *infra*, pages 17a-27a, two examples (Examples 2 and 3) which are directed solely to the issue immediately under discussion (the meaning of "paid or accrued" for purposes of computing net operating loss). These examples picture, on the one hand, the case of a taxpayer having stable income year in and year out, and, on the other hand, the case of a taxpayer having

fluctuating income but earning over the years the same aggregate profits. The examples further illustrate that taxpayer's legal position as to the meaning of "paid or accrued," if adopted, would cause gross discrimination in favor of taxpayers having fluctuating income as opposed to those with stable earnings. The net operating loss deduction provided by Congress was designed to relieve the taxpayer with fluctuating profit and loss years from unjust burdens. There is not the slightest basis for supposing that the corporation with fluctuating profit and loss years, but enjoying over-all profits, was to be equipped with a device for avoiding the imposition of taxes on its over-all profits and thereby placed in a special, privileged class. See Government's Brief in No. 10, page 27. Compare *Reo Motors* v. *Commissioner*, 338 U.S. 442, 449: "We find no warrant for the view that Congress intended that a statute designed to equalize tax burdens should be used to produce net losses where none had previously existed."

Taxpayer here has no real basis for claiming that it has been unfairly treated. Its argument actually comes down to this: that a few cash basis corporate taxpayers may be in a position to secure more favorable treatment. As pointed out in the Government's brief in No. 10, many provisions of the tax laws have a differing incidence depending on the method of accounting being used and it is presumed that the advantages and disadvantages achieve a rough balance over the years, especially since the taxpayer has an election as to which method it will

utilize. It is also evident that there are circumstances in which accrual basis taxpayers may obtain substantial benefits under Section 122(d)(6).[9] In any event, as taxpayer correctly asserts (Br., p. 32), there are "comparatively few cash basis corporate taxpayers." The argument that, under the Government's construction, some of these few may be in a position to obtain more favorable treatment than accrual basis taxpayers is a poor crutch upon which to lean in asserting that the Court should adopt a construction which would cause wholesale discrimination, in very large amounts, in favor of taxpayers having fluctuating income as opposed to those whose earnings are relatively stable. There is no indication that Congress contemplated the extravagant results to which taxpayer's position would lead (see Govt. Br. in No. 10, pp. 28-32), and there is accordingly every reason to adhere to the explicit and long-established statutory definition of "paid or accrued."

2. Taxpayer places considerable reliance upon the line of cases exemplified by *Commissioner* v. *Clarion Oil Co.*, 148 F. 2d 671 (C.A.D.C.), certiorari denied, 325 U.S. 881.[10] However, these cases,

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[9] One example (see Govt. Br. in No. 10, pp. 18-19) is when disputed excess profits taxes of earlier years accrue through settlement or discharge in the loss year. Indeed, the instant taxpayer, in the court below, claimed such an accrual, asserting an addition of more than $355,000 to its 1947 net operating loss. It failed because of a failure in proof. (R. 60-65.)

[10] See, also, *Aramo-Stiftung* v. *Commissioner*, 172 F. 2d 896 (C.A. 2d); *Birmingham* v. *Loetscher Co.*, 188 F. 2d 78 (C.A. 8th); *Harry M. Stevens, Inc.* v. *Johnson*, 115 F. Supp. 310 (S.D.N.Y.), pending on appeal, C.A. 2d.

which involve the penalty surtax on undistributed income of personal holding companies, were properly distinguished in both courts below (R. 33, 68-69) and in the Government's brief in No. 10 (pp. 16-17). The distinction is summarized in Judge Madden's dissenting opinion in the *Olympic* case (No. 10, R. 14), as follows:

> To penalize a corporation for not distributing as dividends money which it either does not have, because it pays it out in back taxes during the year, or which prudence would require it to keep, because it will be needed to pay taxes accrued during the year though not payable until the following year, would seem to amount to penalizing sound management. The instant situation presents no comparable pressure of equity against the text of the statutes.

It should also be noted that in the *Clarion Oil* decision itself the court pointed out (148 F. 2d at 676) that in computing the penalty tax on undistributed income, "[t]here is absent the administrative need for uniformity which exists for the computation of *net* income." The determination of a net operating loss deduction is, of course, an integral part of the computation of net income. To permit one factor in calculation of loss to be computed on the cash basis, while all other calculations of profit and loss entering into a determination of net income are computed on the accrual basis, necessarily distorts net income. The precise function of

Sections 43 and 48(c) is to avoid such a result.[11]

Taxpayer also asserts that the court below misapprehended the *Clarion Oil* line of cases. It states (Br. 21) that the court below—

> plainly in error . . . overlooked Section 507(a) of the Code . . . which states that
>
> "The terms used in this subchapter [subchapter A of Chapter 2, the statute involved in *Clarion Oil*] shall have the same meaning as when used in Chapter 1."

This is rested upon the following sentence in the Court of Appeals' opinion (R. 68): "*Stated otherwise*, Chapter 2 contains no provisions comparable to §48(c) and §43 of Chapter 1 defining the phrase 'paid or accrued.'" (Emphasis added.)

A reading of the two preceding sentences (not quoted by taxpayer) shows, however, that the court was not oblivious of Section 507(a), and that it correctly interpreted the *Clarion Oil* case as holding that the Chapter 1 definition of "paid or accrued" was not meaningful for purposes of determining

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[11] The scheme of the Code with respect to taxation of undistributed income of foreign personal holding companies (Sections 331-340) does not support taxpayer's argument as to the meaning of the *Clarion Oil* cases (Br., pp. 26-27). In computation of the undistributed income of these companies there is also absent the administrative need for uniformity which exists for the computation of net income. That the tax is imposed not upon the company but upon its "United States shareholders" in the guise of a constructive dividend seems quite irrelevant. Section 337. There is, of course, no correlation between accounting systems or income computation of a corporation and a stockholder.

when a personal holding company had undistributed income. These two sentences read as follows (R. 68):

> The ground of these decisions, as exemplified by *Clarion*, is that the provisions of § 48(c) in Chapter 1 of the Internal Revenue Code defining "paid or accrued" in terms of a taxpayer's method of reporting for the purpose of computing *net income* under that Chapter, have no application to the meaning of § 505 (a)(1) permitting deduction of excess profits taxes for the purpose of computing the *undistributed income* tax on personal holding companies under Chapter 2. "But, obviously, this definition [48(c)] was intended to apply to the method of computing *net income*, and has no reference or relevancy to the subject matter of what, for the purposes of the newly added provision in relation to personal holding companies is taxable as *undistributed* income." *Clarion*, at p. 675.[12]

Resting on the *Clarion Oil* line of cases, taxpayer further asserts (Br. 20) that "[i]t is the established rule that the term 'paid or accrued' may have different meanings in the Internal Revenue Code, and that, where appropriate to carry out the statutory purpose, the ordinary meaning of *either* 'paid or accrued' will be applied rather than

[12] It may be noted additionally that the Tax Court's opinion (R. 33) expressly noted Section 507(a) and that the court below considered it unnecessary to amend the questioned language in its opinion when this point was pressed upon it by taxpayer's petition for rehearing.

the statutory definition in Section 48(c)." But, as the preceding discussion shows, those cases actually confirm the Government's contention that in computation of net income and in taking deductions incident to calculation of net income (of which the net operating loss is one) the term "paid or accrued" possesses only one meaning—that prescribed in Sections 43 and 48(c). Moreover, the construction of "paid or accrued" required by those sections, *i.e.*, according to the method of accounting upon the basis of which net income is computed, surely constitutes the term's "ordinary" meaning in the context of determination of net income or of deductions taken incident to net income calculation. A contrary construction—one that would permit a taxpayer to elect one basis for certain deductions and the other basis for others—must distort net income. Even without an explicit statutory definition, one would hardly ascribe to Congress the purpose of authorizing a single taxpayer to adopt internally inconsistent methods of computing profit and loss factors.

Helvering v. *Morgan's, Inc.*, 293 U.S. 121, also cited by taxpayer (pp. 20-21), affords it no support. The Court noted (p. 128) that the phrase "taxable year" there involved possessed more than one meaning "by the Government's own construction"; on the contrary, "paid or accrued," for purposes of computing net income, has only one statutory meaning.[13]

[13] Moreover, in *Morgan's, Inc.*, this Court applied the cognate of Section 48(a) (Revenue Act of 1926, c. 27, 44 Stat. 9, Section 200(a)) to the net loss provision of the 1926 Act

3. Taxpayer asserts (Br., p. 32) that subsection (e)(2) of Section 105 of the 1942 Act furnishes a key to the Congressional purpose—a suggestion which is made for the first time in this Court. In our view, that subsection is irrelevant to the issue at hand.

Section 102 of the Internal Revenue Code imposes a surtax in the nature of a penalty on corporations improperly accumulating surplus. Section 102(d)(1) defines the income subject to the penalty tax, denoted as "section 102 net income." Congress did not intend that income which had been subjected to excess profits tax should additionally be subject to this penalty tax. Accordingly, Section 105(e)(2) of the 1942 Act amended Section 102(d)(1) of the Code so as to provide an additional item for subtraction in arriving at "section 102 net income," namely, net income "minus" . . . "Income Subject to Excess-Profits Tax.—The credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26(e)."

As explained in the Government's brief in No. 10, pages 26-34, the 1942 Act changed the base for the corporate tax by allowing a taxpayer, in

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(Section 206), just as the House Committee in recommending enactment of Section 122 assumed the applicability of the definition in Section 48(a) to Section 122 (see Government's brief in *Olympic*, p. 15, fn. 7). The dispute in *Morgan's, Inc.*, centered about the meaning of Section 200(a); its materiality in construing the net loss provision was not in question (p. 130). The apparent implication to the contrary in taxpayer's brief (p. 28, fn. 22) is incorrect.

computing the normal tax and surtax, to use as a credit the amount of adjusted excess profits net income, instead of (as theretofore) a deduction in the amount of the excess profits tax itself. See Government's brief in *Olympic*, Appendix B, Examples 1 and 2, pages 54-55. This credit was provided in Section 26(e) as added by Section 105(d) of the 1942 Act. Thus, subsection (e)(2) did no more than allow, in the case of the surtax on corporations improperly accumulating surplus, the same credit against net income that was generally allowed in computing the normal tax and surtax. It was thus aptly included in Section 105(e) among "Technical Amendments Made Necessary by Change in Base for Corporate Tax." It does not serve to advance the argument here one way or the other.

II

Under Section 122(d)(6), As Incorporated by Reference In Section 122(b)(1), "The Amount of Tax Imposed By Subchapter E of Chapter 2 [Excess Profits Tax] Paid or Accrued Within the Taxable Year" Is the Amount of Excess Profits Tax Ultimately Found to be Due for That Year and Not the Amount Which Taxpayer Originally Reported on Its Return.

A. *The Setting of the Problem*

As indicated under Point I, the answer to the first question in this case bears on the quantum of taxpayer's net operating loss for 1946. A net operating loss, once determined, may be utilized as

a two-year carry-back or carry-over. Section 122 (b). The remaining considerations in the case relate to the manner of applying the 1946 net operating loss carry-back to the profit years 1944 and 1945.[14] The governing statutory provision is Section 122(b)(1).[15] See, also, Treasury Regulations 111, Sections 29.122-4 and 29.122-5 (Appendix A, *infra*, pp. 1a-11a).

Section 122(b)(1) directs that the net operating loss for a given year (here, 1946) shall first be carried back and deducted from the income of the second preceding year (1944). Thus, on taxpayer's theory, one would apply a 1946 net operating loss totaling $1,025,444.42 against a 1944 net income

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[14] As will appear, these considerations are not divorced from factors involved in the discussion under Point I.

[15] Sec. 122. [As added by Sec. 211(b) of the Revenue Act of 1939, c. 247, 53 Stat. 862] NET OPERATING LOSS DEDUCTION.

* * * * *

(b) [As amended by Sec. 153(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

(before carry-back) of $584,866.81.[16] This would entirely wipe out taxpayer's income and excess profits tax liabilities for 1944. On the Government's theory, the net operating loss for 1946 is $164,326.38. Application of that figure against $584,866.81 would diminish but not eliminate taxpayer's liabilities for 1944.

Difficulties arise, however, from taxpayer's contentions in relation to the effect of the 1946 net operating loss upon its liabilities for 1945. In determining the amount of carry-back available for the first preceding year (1945), Section 122(b)(1) provides in substance that it shall be the excess of the 1946 net operating loss over an adjusted figure for 1944 net income. As under Point I, it is the "(d)(6)" adjustment (but here in relation to 1944 income) which is the bone of contention. Taxpayer's position on application of the carry-back is

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[16] The following table illustrates its position graphically:

1944		
Net income before carry-back of 1946 net operating loss (R. 4, 70; Taxpayer's Br. p. 5)		$ 584,866.81
Loss carry-back for 1946 computed as follows:		
1946 net operating loss (R. 70) exclusive of Section 122(d)(6) adjustment	$164,326.38	
1945 excess profits tax paid in 1946 (R. 66; Taxpayer's Br. p. 4)	861,118.04	
Total 1946 net operating loss		1,025,444.42
Net income		($ 440,577.61
Income tax		0 *

* Excess profits tax is also zero. Section 710(a)(1)(B).

summarized in the Court of Appeals' opinion (R. 70-71) as follows:

> The taxpayer contends that in computing the amount of the 1946 net operating loss . . . which is to be carried back to 1945, there should first be offset against 1944 net income ($584,866.81) either (a) the sum of $759,916.50, being the amount of the 1943 excess profits taxes reflected in the taxpayer's return for that year and *paid* by it in 1944, or (b) the sum of $625,561.59, being the amount of the 1944 excess profits taxes as reflected in the taxpayer's return for 1944, and which it claims *accrued* in 1944. Since under (a) the 1943 excess profits taxes *paid* in 1944 ($759,916.50) exceeded by $175,049.69 the unadjusted net income for 1944 ($584,866.81) and under (b) the 1944 excess profits taxes *accrued* for that year ($625,561.59) exceeded by $40,694.78 such net income for 1944 ($584,866.81), the taxpayer claims that the entire 1946 net operating loss . . . constitutes a "carry-back" to 1945.

Taxpayer thus asserts, to begin with, that its net operating loss (claimed to be $1,025,444.42) wipes out 1944 tax liabilities. It then asserts, in substance, that its 1944 income, amounting to well over half a million dollars, *although wiped out by the 1946 net operating loss for purposes of computing taxpayer's 1944 taxes, failed to absorb a single penny of the 1946 net operating loss for purposes*

of determining what is available for carry-back to 1945. In the Court of Appeal's words (R. 70-71), "taxpayer claims that the entire 1946 net operating loss . . . constitutes a 'carry-back' to 1945." Stated graphically, taxpayer reaches this result as follows:

1945

A.	Computation of net operating loss carry-back from 1946 to 1945		
	1946 net operating loss		$1,025,444.42
	Less: 1944 income without regard to 1946 net operating loss (Sec. 122(b) (1) (B)	$584,866.81	
	Less: *1943 excess profits tax reported by taxpayer, paid in 1944* (Sec. 122(b) (1) (A)) (R. 70; Br. 5)	759, 76.50 [17]	
	Total 1946 net operating loss absorbed by 1944 net income		—0—
	Amount of 1946 net operating loss carried back to 1945		$1,025,444.42
B.	Computation of 1945 net operating loss deduction		
	Carry-back from 1946		$1,025,444.42
	Carry-back from 1947 (R. 60)		786,383.25
	1945 net operating loss deduction (Sec. 122 (c))		$1,811,827.67

[17] If one substitutes for this figure the sum of $625,561.59, representing the sum of excess profit tax *reported* for 1944 taxpayer's alternate suggestion the end result remains unchanged: the total net operating loss absorbed by 1944 net income is still zero.

C. Income and Excess Profits Tax Computation

1945 net income before carry-back (R. 10-11)[18]	$1,069,252.50
Less: Net operating loss carry-back	1,811,827.67
Net income	($742,575.17)[19]
Income Tax	—0—
Excess Profits Tax under Section 710(a) (1) (B)	—0—

Recapitulating, taxpayer's over-all position embraces these propositions:

(1) In computing net operating loss for 1946, it may include excess profits taxes accrued in 1945 and paid in 1946, notwithstanding the fact that it is an accrual basis taxpayer.

(2) In applying the carry-back to 1945 and in determining for that purpose the excess of the 1946 net operating loss over 1944 net income, it may deduct from 1944 net income either—

(a) the sum representing excess profits taxes *reported* for 1943 and paid in 1944, *or*

(b) the amount representing excess profits taxes *reported* for 1944.

Whether in making the "(d)(6)" adjustment to 1944 net income one should deduct excess profits taxes accrued in 1943 and paid in 1944 or excess profits taxes accrued in 1944 is the same question

[18] Net income for 1945 of $282,869.25, plus 1947 net operating loss carry-back, $786,383.25.

[19] Application of taxpayer's theory, in computing carry-overs for future years under Section 122(b)(2), would have the effect of adding to this minus figure of $742,575.17, the amount of 1944 excess profits tax reported by taxpayer, paid in 1945.

considered under Point I. The meaning of "paid or accrued," as used in Section 122(d)(6), must be the same—and, as to this, there is no argument between the parties—whether a "(d)(6)" adjustment is being made to 1946 net loss (pursuant to Section 122(a)) or to 1944 net income (pursuant to Section 122(b)(1)). However, a further, distinct issue is involved in taxpayer's contentions as set forth in propositions 2 (a) and (b) above. Taxpayer is suggesting that the amount of excess profits tax to be deducted from 1944 net income is the amount *reported* rather than the amount *ultimately found to be due*. This issue is in the case irrespective of the Court's holding under Point I as to the amount of 1946 net operating loss. [20]

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or $510,939.23, making available a carry-over for 1948 and 1949 in excess of $1,000,000. (See computation, Example 4, Appendix B, *infra*, p. 28a.)

[20] The decision of the courts below, which ruled in favor of the Government on Questions 1 and 2, has the following effect:

1945

Computation of net operating loss carry-back from 1946 to 1945		
1946 net operating loss		$164,326.38
Less: 1944 income without regard to 1946 net operating loss (Sec. 122(b)(1)(B)	$584,866.81	
Less: *1944 excess profits tax actually imposed* (Sec. 122(b)(1)(A)	280,540.33	
Balance of 1944 income		304,326.48
Amount of 1946 net operating loss carry-back to 1945		—0—

(Footnote 20 continued on page 32)

B. *For Purposes of the "(d)(6)" Adjustment, the Tax "Imposed" Is the Tax Ultimately Found to be Due.*

Taxpayer reported $625,561.59 as its excess profits tax for 1944 (R. 40A, 70-71). The amount ultimately found due was $280,540.33 (R. 9, 24, 71). The difference was refunded or credited to taxpayer (R. 9).[21]

Taxpayer suggests, however, that in determining the amount of carry-back from 1946 absorbed by 1944 net income (Section 122(b)(1)) one should deduct from 1944 net income the amount of excess

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(Footnote 20 continued from page 31)

If, however, taxpayer were to prevail on Question 2, one would substitute for the italicized item the sum of $625,561.59 (excess profits tax for 1944 as originally reported by taxpayer). This would result in a "balance of 1944 income" of zero and "a net operating loss carry-back to 1945" of $164,326.38. *Again, the result would be that taxpayer would receive the benefit of the entire 1946 net operating loss in 1945, notwithstanding the fact that it had already applied the full amount of that loss in reduction of its 1944 liabilities.*

Moreover, if taxpayer should prevail on Point I and the Government should prevail on Point II, adjustments would be required. See p. 39, fn. 28, *infra*.

[21] Similarly, taxpayer reported as its 1943 excess profits tax a sum ($759,916.50) (R. 24, 70) substantially in excess of that ultimately found to be due ($140,147.87) (R. 26, 61). The former amount was paid in 1944. The difference between the two amounts was refunded or credited. In our view, of course, the 1943 data is immaterial from the standpoint of adjustment of 1944 net income since taxpayer is on the accrual basis (see Point I). But for purposes of the point now under discussion—whether one deducts from 1944 net income the excess profits tax reported or that ultimately found due—the principle is the same whether taxpayer or the Government is correct on Point I.

profits tax reported for 1944.[22] In short, it urges that an amount which it has already gotten back once (the difference between $625,561.59 and $280,540.33) should be treated as diminishing its 1944 net income. On this basis, it would increase, *pro tanto*, the figure used in computing the amount of carry-back available to it for application against 1945 net income. The practical consequence, as revealed in the computations set forth above (see pp. 29-30 and p. 27, fn. 16), is that taxpayer would get the benefit of the 1946 carry-back in 1944 and still have the benefit of the *entire* carry-back in 1945. This position is untenable.

The basic purpose of Congress in authorizing a carry-back is plain. The law says in effect that, when a loss year follows years of profit, there shall be a readjustment of tax liability for the earlier period in the light of the later event. It seems inconceivable that Congress proposed that this adjustment should be made without regard to the known and established facts relating to the liability for the earlier period. Yet, taxpayer, in order to enhance its carry-back, would have the Commissioner, in making the retrospective adjustment, include in his determination of the tax liability "im-

[22] This statement assumes that the Government is correct on Point I. On the contrary assumption, taxpayer's position is that one should deduct from 1944 net income the amount of excess profits tax reported for 1943 and paid in 1944 (rather than the corrected excess profits tax liability for 1943). As indicated in the preceding footnote, the principle involved is the same. Consequently, we shall not repeat the alternatives at each stage of the ensuing argument.

posed" during the earlier period an amount already once refunded or credited to the taxpayer. A law designed to provide relief retrospectively is scarcely to be read as providing a double benefit, especially where the claim to double benefit is predicated upon the use of a figure which has no economic reality.

Under the statutory formula, the amount of carry-back available for the first preceding year (1945) is the excess of the carry-back over the net income for the second preceding year (1944) as adjusted pursuant to Section 122(d)(6). Subsection (d)(6) expressly allows as a deduction "the amount of [excess profits] tax imposed. . . ." There were not two excess profits taxes imposed for 1944, but only one, and that one was the amount as finally determined after the making of some thirteen corrections (R. 4-6).[23]

Taxpayer's theory suffers, moreover, from a glaring internal inconsistency. Taxpayer would deduct from 1944 net income the sum of $625,561.59 representing its uncorrected excess profits tax for 1944. But it does not propose that this sum be deducted from the uncorrected figure ($827,852.99) on the basis of which the reported tax was computed (R. 40A, Item 1). Its position is that it may deduct the *uncorrected* tax from the *corrected* net

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[23] Some of these corrections involve errors by taxpayer. Others reflect events (*e.g.*, renegotiation of war contracts) which occurred after the close of the taxable year. Taxpayer suggests only that the "reported" figure be used. Br., pp. 2, 38.

income ($584,866.81).[24] In the Court of Appeals' words (R. 71), "[w]hat the taxpayer is seeking to do is to have the benefit of both the *smaller* 1944 income as finally determined ($584,866.81) and the *larger* excess profits tax ($625,561.59), based upon the income as originally reported. . . . It cannot have it both ways at the same time by matching *determined* income against *returned* [*i.e.*, reported] excess profits taxes."

Taxpayer's approach may be illustrated concretely by taking one of the items originally included in taxpayer's 1944 return which became the subject of a later correction. Reported income for 1944 ($827,852.99) included accrued profits on certain outstanding war contracts. These accounted in substantial measure for the reported excess profits tax liability of $625,561.59. Subsequently, however, the contracts were renegotiated and the amount to which taxpayer became entitled thereunder was reduced by $397,970 (R. 4, 6). Taxpayer thereupon received a tax credit of $318,577.67 (R. 9) against the tax originally reported.[25]

In determining the amount of 1946 carry-back absorbed by 1944, taxpayer, as already observed, would reduce 1944 net income *as corrected* by 1944

[24] This figure represents the 1944 net income of $420,546.43 (upon which the excess profits tax as finally determined — $280,540.33 — was computed) plus the net operating loss of $164,326.38. (See R. 4.) For purposes of application of Section 122(b)(2), the income as finally determined is the 1944 income plus the 1946 net operating loss.

[25] The credit was allowed pursuant to Section 3806(b). *See Stow Mfg. Co. v. Commissioner*, 190 F. 2d 723 (C. A. 2d), certiorari denied, 342 U. S. 901; *Standard Roofing & Material Co. v. United States*, 199 F. 2d 507 (C. A. 10th).

excess profits tax *as reported*. This means, of course, that the principal sum of $397,970, originally reported as income, is out of the picture. Nonetheless, the amount of $318,577.67, representing the amount of reported tax on this principal sum, is to be deducted, according to taxpayer, from 1944 income as corrected. Credited once to taxpayer, it arises, phoenix-like, from the ashes. It stands, under taxpayer's view, as a liability "imposed" and serves to increase, *pro tanto*, the figure to be used in determining the carry-back remaining for application to 1945 net income.

While taxpayer seeks comfort from *Manning* v. *Seeley Tube & Box Co.*, 338 U.S. 561, the opinion in that case fairly supports the Government's position here. The issue in *Seeley Tube* was whether a taxpayer which failed to pay taxes when due and thus retained, over a period of time, "the use of funds which rightfully should have been in the possession of the United States" (p. 566) was excused from paying interest on a validly assessed deficiency because the deficiency was later abated by virtue of a loss carry-back. This Court properly held that later, unforeseeable events may not retroactively excuse a taxpayer's failure to pay taxes on the original due date. The Court took note, however, at the same time, that "for many purposes the carry-back is equivalent to a *de novo* determination of the tax . . ." (p. 567).

Unlike the situation in *Seeley Tube*, we are not determining here what the taxpayer was originally obliged to report and pay. We are seeking to ascertain what taxpayer is entitled to get back, by

way of relief, in view of the fact that it later suffered an unforeseeable loss. One would hardly suppose that Congress, in authorizing such a *de novo* determination, aimed to provide relief in respect of earlier taxes already in large measure refunded. The word "imposed" in Section 122(d)(6) plainly avoids that absurdity. As the Court of Appeals stated (R. 72):

> . . . it is *determined* income and excess profits taxes that represent the proper § 122(d)(6) adjustment, since the manifest purpose of the "carry-back" and "carry-over" provisions of the statute, § 122(b)(1), (2) is that the incidence of this kind of taxation upon a business enterprise shall in effect be looked at from the vantage point of a five year period, that is the current taxable year plus two "carry-back" and two "carry-over" taxable years.[26]

Taxpayer points out (Br., pp. 49-51) that, under the Court of Appeals' construction, it will receive

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[26] Taxpayer points (Br. 39-40) to Rev. Rul. 6, 1953-1 Cum. Bull. 120, which provides that in computing "section 102 net income" (the income upon which the penalty surtax on a corporation improperly accumulating surplus is imposed), the deduction for federal income taxes paid or accrued during the taxable year (Section 102(d)(1)(A)) means the amount of income tax accrued at the end of the taxable year without reduction resulting from a net operating loss carry-back of a later year. But that situation is not a comparable one. Congress did not intend that the penalty tax imposed under Section 102 should apply to income which a taxpayer was required to set aside for payment of income taxes in the amount known to him at the end of the taxable year. On the other hand, the plain purpose of the net operating loss provisions is to effect an exception to the annual period for tax accounting and to substitute a five-year unit. Note,

no special benefit from the provision in Section 122(b)(1) authorizing a "(d)(6)" adjustment. Taxpayer's claim that this is a "harsh result" (Br., p. 51) should not obscure the fact that the entire amount of the 1946 net operating loss has been applied *once* under the holding of the courts below. The full amount of the loss, found to have been $164,326.38, has been offset against taxpayer's net income for 1944 for purposes of determining taxpayer's liabilities for 1944. The effect of the decision is that no part of that sum is available again for offset in 1945 (in contrast to taxpayer's theory which would make the amount available once again *in toto*).[27] We agree with taxpayer that, under the holding below, Section 122(d)(6) has limited rather than broad application to accrual basis taxpayers. Typical situations in which it will benefit such taxpayers (either in computing net loss or net income) are discussed in the Government's brief in No. 10, pages 17-20. We cannot believe that the sweeping and truly astonishing results which taxpayer would attribute to "(d)(6)" are warranted either by the provision's

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also, that the language of Section 122(d)(6) differs significantly from that of Section 162(d)(1)(A) in that (d)(6) expressly limits the deduction to the "amount of tax *imposed*" (emphasis added).

[27] As noted earlier, taxpayer's contentions, if it prevailed under both Points I and II, would result in the conclusion that actual losses for 1946 and 1947 aggregating $950,709.63 offset completely aggregate profits for 1944 and 1945 of $1,654,119.31 and provide, additionally, a potential carry-over of more than $1,000,000.

terms or by its obscure history as a "technical" amendment.

CONCLUSION

The courts below were correct in holding (Point I) that an accrual basis taxpayer, computing a net operating loss for 1946, is not entitled to take into account excess profits taxes accrued in 1945 and paid in 1946. The finding that the 1946 net operating loss amounted to $164,326.38 is accordingly correct.

The decision below is also correct in holding (Point II) that, for purposes of determining the amount of 1946 carry-back available for application to 1945, taxpayer may not deduct from 1944 net income the amount of excess profits tax reported for 1944 but may only take into account, under the statutory formula (Section 122(b)(1), incorporating by reference Section 122(d)(6)), the amount of 1944 excess profits taxes ultimately found to be due.[28] The finding that the 1946 net

[28] Section 122(d)(6) is, of course, incorporated by reference in both Section 122(a) and Section 122(b)(1). Hence, if this Court should reverse on Question 1 and affirm on Question 2, the decision would affect *both* the computation of net operating loss for 1946 and the application of such loss to the prior years. Note that in both 1945 and 1943 taxpayer's reported excess profits taxes exceeded the amounts ultimately found due.

operating loss was absorbed in 1944 is accordingly correct.

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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APRIL, 1955.

APPENDIX A

For Internal Revenue Code of 1939, Sections 23(c)(1) and (s), 41, 43, 48(c), 122, 710(a)(1) and (b), 711(a)(1)(J) and (2)(L), and Treasury Regulations 111, Sections 29.41-1, 29.41-2, 29.43-1, 29.122-1 and 29.122-2, see Brief for the United States in the companion case of *United States* v. *Olympic Radio and Television, Inc.*, No. 10, Appendix A, pp. 36-53.

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

> Sec. 29.122-4. *Computation of Net Operating Loss Carry-Overs and Net Operating Loss Carry-Backs.*—(a) *In general.*—The aggregate of any net operating loss carry-overs and any net operating loss carry-backs to a taxable year shall be the basis of the net operating loss deduction. In order to compute such deduction, the taxpayer must first determine the part of any net operating losses for the two preceding taxable years which are carry-overs to the current taxable year, and the part of any net operating losses for the two succeeding taxable years which are carry-backs to the current taxable year
>
> Under section 122 the net operating loss for any taxable year beginning on or after January 1, 1942, may be carried back to the two preceding taxable years (except any such taxable year which began before January 1, 1941) and may be carried over to the two succeeding taxable years. The net operating loss for any taxable year beginning before January 1, 1942, may be carried over to the two succeeding tax-

able years, regardless of whether such year begins before, on, or after January 1, 1941. The amount which is so carried back or carried over to any taxable year is the net operating loss to the extent it was not absorbed in the computation of the net income for other taxable years, preceding such taxable year, to which it was carried back or carried over. For the purpose of determining the net income for a taxable year which so absorbs the net operating loss that is carried back or carried over, the various net operating loss carry-overs and carry-backs to such taxable year are considered to be applied in reduction of the net income for such taxable year in the order of the taxable years from which such losses are carried over or carried back, beginning with the loss for the earliest taxable year.

(b) *Portion of net operating loss which is a carry-over or a carry-back to the current taxable year.*—The net operating loss sustained in any taxable year beginning before January 1, 1942, may be carried over to the two succeeding taxable years. The entire net operating loss may be carried over to the first succeeding taxable year, and the carry-over to the second succeeding taxable year is the excess of the net operating loss over the net income, if any, for the first succeeding taxable year (computed as provided in subsection (c) of this section). For example, the taxpayer had a net operating loss of $10,000 in 1940. It had a 1941 net income of $6,000 (computed as provided in subsection (c) of this section). The carry-over from 1940

to 1942 is $4,000, the excess of the $10,000 loss over the $6,000 net income for 1941.

The net operating loss sustained in any taxable year beginning on or after January 1, 1942, may be carried back to the two preceding taxable years (not considering as a preceding taxable year a year beginning prior to January 1, 1941) and may be carried over to the two succeeding taxable years. The entire net operating loss may be carried back to the second preceding taxable year. However, if the second preceding taxable year began before January 1, 1941, no part of the net operating loss may be carried back to such taxable year, and the net income for such taxable year does not reduce the amount of the net operating loss which may be carried back or carried over to the other taxable years. The net operating loss, to the extent it exceeds the net income, if any (computed as provided in subsection (c) of this section), for the second preceding taxable year, may then be carried back to the first preceding taxable year. To the extent that the net operating loss exceeds the aggregate of the net income, if any (computed as provided in subsection (c) of this section), for the two preceding taxable years, it may be carried over to the first succeeding taxable year. To the extent that the net operating loss exceeds the aggregate of the net income, if any (computed as provided in subsection (c) of this section), for the two preceding taxable years and for the first succeeding taxable year, it may be carried over to the second succeeding taxable year.

Example. The taxpayer has a net operating loss of $100,000 in 1943. It has net income (computed as provided in subsection (c) of this section) as follows: $10,000 in 1941, $15,000 in 1942, $35,000 in 1944, and $60,000 in 1945. The net operating loss carry-back from 1943 to 1941 is $100,000, an amount equal to the full net operating loss. The carry-back to 1942 is $90,000, the excess of the $100,000 net operating loss over the $10,000 net income for 1941 (computed as provided in subsection (c) of this section). The carry-over to 1944 is $75,000, the excess of the $100,000 net operating loss over the aggregate of the $10,000 net income for 1941 and the $15,000 net income for 1942 (computed in each instance as provided in subsection (c) of this section). The carry-over to 1945 is $40,000, the excess of the $100,000 net operating loss over the aggregate of the $10,000 net income for 1941, the $15,000 net income for 1942, and the $35,000 net income for 1944 (computed in each instance as provided in subsection (c) of this section).

(c) *Computation of net income which is subtracted from net operating loss to determine carry-back or carry-over.*—The net income for any taxable year which is subtracted from the net operating loss for another taxable year to determine the portion of such net operating loss which is a carry-back or carry-over to a particular taxable year as provided in subsection (b) of this section is computed with the following adjustments:

(1) The net operating loss deduction for such taxable year is computed by taking into

account only such net operating losses otherwise allowable as carry-overs or carry-backs to such taxable year as were sustained in taxable years preceding the taxable year in which the taxpayer sustained the net operating loss from which the net income is to be deducted.

Example. In computing the net operating loss deduction for 1945, the taxpayer has a carry-over from 1943 of $9,000, a carry-over from 1944 of $6,000, a carry-back from 1946 of $18,000, and a carry-back from 1947 of $14,000, or an aggregate of $47,000 in carry-overs and carry-backs which is the basis for the deduction. In computing the net income for 1945 which is deducted from the net operating loss for 1946 in order to determine the portion of such net operating loss which may be carried over to 1947 or 1948, the net operating loss deduction for 1945 is computed without taking into account the $18,000 carry-back from 1946 or the $14,000 carry-back from 1947. The net operating loss deduction for 1945 is, for the purposes of such computation, the aggregate of the $9,000 carry-over from 1943 and the $6,000 carry-over from 1944, or $15,000, adjusted as provided in section 29.122-5 (relating to the conversion of the aggregate of the net operating loss carry-overs and carry-backs to the taxable year into the net operating loss deduction).

In computing the net income for 1945 which is deducted from the net operating loss for 1947 in order to determine the portion of such loss which may be carried back to 1946 and carried over to 1948 and 1949, the net operat-

ing loss deduction for 1945 is computed without taking into account the $14,000 carry-back from 1947, and as so computed is the aggregate of the $9,000 carry-over from 1943, the $6,000 carry-over from 1944, and the $18,000 carry-back from 1946, or $33,000, adjusted as provided in section 29.122-5.

(2) In the case of a corporation, the net income shall be computed in accordance with the exceptions, additions, and limitations applicable in the computation of a net operating loss (see section 29.122-2), except that the net operating loss deduction shall be allowed to the extent provided in paragraph (1) above.

* * * * *

(4) (as amended by T. D. 5600, 1948-1 Cum. Bull. 5) Any deduction which is limited in amount to a percentage of the taxpayer's net income, or adjusted gross income for taxable years beginning after December 31, 1943, shall be recomputed upon the basis of the net income or adjusted gross income, as the case may be, determined with the adjustments prescribed in the preceding paragraph.

(5) The net income, as adjusted, shall in no case be considered less than zero.

(d) *Illustration of computation of net operating loss carry-backs and carry-overs.*—The application of this section may be illustrated by the following example:

Example. The taxpayer is a corporation making its income tax returns on the calendar year basis. It had no net operating loss in 1939

or 1940, or in 1948 or 1949. Its net income, computed without any net operating loss deduction (it being assumed that none of the other adjustments provided in subsection (c) of this section is applicable), was $20,000 in 1941, $35,000 in 1942, $30,000 in 1946, and $85,000 in 1947. It sustained net operating losses as follows: $25,000 in 1943, $50,000 in 1944, and $40,000 in 1945. It is assumed for the purposes of this example that the application of section 29.122-5 does not cause any reduction of the amount of the aggregate of the net operating loss carry-overs and carry-backs to any taxable year, so that such aggregate is the net operating loss deduction for such taxable year.

(1) The portions of the $25,000 net operating loss for 1943 which may be used as carry-backs to 1941 and 1942 and as carry-overs to 1944 and 1945 are computed as follows:

(A) For 1941, the carry-back is $25,000, that is, the amount of the net operating loss.

(B) For 1942, the carry-back is $5,000, that is, the excess of the $25,000 net operating loss over the $20,000 net income for 1941 (such net income being determined without any net operating loss deduction since there is no carry-over to 1941 from 1939 or 1940 and no carry-back from 1942, and the carry-back from 1943 is not taken into account).

(C) For 1944 and 1945, there is no carry-over of the net operating loss for 1943 since such loss does not exceed $55,000, the sum of the net incomes for the two taxable years preceding 1943 computed as provided in sub-

section (c) of this section (the $20,000 net income for 1941 and the $35,000 net income for 1942, there being no net operating loss deduction for either taxable year since the carry-backs from 1943 and from 1944 are not taken into account).

(2) The portions of the $50,000 net operating loss from 1944 which may be used as carry-backs to 1942 and 1943 and as carry-overs to 1945 and 1946 are computed as follows:

(A) For 1942, the carry-back is $50,000, that is, the amount of the net operating loss.

(B) For 1943, the carry-back is $20,000, that is, the excess of the $50,000 net operating loss over the $30,000 net income for 1942 (the $35,000 income for 1942 reduced by the $5,000 carry-back from 1943, the carry-back from 1944 not being taken into account).

(C) For 1945, the carry-over is $20,000, that is, the excess of the $50,000 net operating loss over $30,000, the sum of the $30,000 net income for 1942 (computed with the deduction of the $5,000 carry-back from 1943 and without the deduction of the carry-back from 1944) and the $0 net income for 1943 (a year in which a net operating loss was sustained).

(D) For 1946, the carry-over is $20,000, that is, the excess of the $50,000 net operating loss over $30,000, the sum of the $30,000 net income for 1942 (computed with the deduction of the $5,000 carry-back from 1943 and without the deduction of the carry-back from 1944) and the $0 net income for 1943

and 1945 (years in which net operating losses were sustained).

(3) The portions of the $40,000 net operating loss for 1945 which may be used as carry-backs to 1943 and 1944 and as carry-overs to 1946 and 1947 are computed as follows:

(A) For 1943, the carry-back is $40,000, that is, the amount of the net operating loss.

(B) For 1944, the carry-back is $40,000, that is, the excess of the $40,000 net operating loss for 1945 over $0, the net income for 1943 (a year in which a net operating loss was sustained).

(C) For 1946, the carry-over is $40,000, that is, the excess of the $40,000 net operating loss for 1945 over $0, the sum of the net incomes for 1943 and 1944 (years in which net operating losses were sustained).

(D) For 1947, the carry-over is $30,000, that is, the excess of the $40,000 net operating loss for 1945 over $10,000, the sum of the $0 net incomes for 1943 and 1944 and the $10,000 net income for 1946 (such net income for 1946 being computed as the $30,000 income reduced by the net operating loss carry-over of $20,000 from 1944, the $40,000 carry-over to 1946 from 1945 not being taken into account).

For 1941, the net operating loss deduction is determined to be $25,000, that is, the carry-back from 1943.

For 1942, the net operating loss deduction is determined to be $55,000, that is, the ag-

gregate of the carry-back of $5,000 from 1943 and of the carry-back of $50,000 from 1944.

For 1946, the net operating loss deduction is determined to be $60,000, that is, the aggregate of the $20,000 carry-over from 1944 and the $40,000 carry-over from 1945.

For 1947, the net operating loss deduction is determined to be $30,000, that is, the carry-over from 1945.

* * * * *

Sec. 29.122-5. *Conversion of Net Operating Loss Carry-Over Into Net Operating Loss Deduction.*—The net operating loss deduction for any taxable year is the aggregate of the net operating loss carry-overs and carry-backs to such taxable year computed as prescribed in section 29.122-4, reduced by the excess of the net income for such taxable year (computed in the same manner as the net income is computed for the purposes of section 29.122-4 except that no net operating loss deduction shall be taken into account and no deduction for excess profits tax imposed by subchapter E of chapter 2 shall be taken into account) over—

* * * * *

(2) in the case of a corporation, the normal-tax net income computed without regard to the exceptions, additions, and limitations specified in section 29.122-2 except that no net operating loss deduction shall be taken into account and the credit provided in section 26 (e) for income subject to the excess profits tax shall not be allowed.

The application of this section may be illustrated by the following example:

Example. The aggregate of the net operating loss carry-overs and carry-backs to 1942 for the X Corporation is $55,000. Its net income for 1942, computed with the adjustments required by this section, is $450,000 and its normal-tax net income, computed without any exceptions, additions, and limitations except that no net operating loss deduction is allowed and the credit provided in section 26 (e) for income subject to the excess profits tax is not allowed, is $445,000. The net operating loss deduction available to the X Corporation for the year 1942 is $50,000, computed as follows:

Aggregate of net operating loss carry-overs and carry-backs to 1942	$55,000
Less: Excess of net income for 1942, with adjustments, over normal-tax net income for 1942, without adjustments except that no net operating loss deduction shall be allowed and the credit provided in section 26(e) for income subject to the excess profits tax shall not be allowed ($450,000 minus $445,000)	5,000
Net operating loss deduction for 1942	$50,000

* * * * *

APPENDIX B

Example 1

Illustration of Computation of Corporate Income and Excess Profits Taxes of Taxpayer with Stable Income for Taxable Years Ended September 30, 1944, to September 30, 1947

The hypothetical X Corporation with income of $187,385 for each of the four years above stated would have paid excess profits and income taxes aggregating $427,393 on total income of $749,543.44.

Schedule 1

Year Ended	*Net Income*	*Tax Liability*	
September 30, 1944	$187,385.86	Income -	$ 20,160.75
		Excess profits -	115,316.59
September 30, 1945	$187,385.86	Income -	19,046.86
		Excess profits -	114,340.39
September 30, 1946	$187,385.86	Income -	58,116.29
		Excess profits -	29,634.81
September 30, 1947	$187,385.86	Income -	70,777.63
Total	$749,543.44		$427,393.32

The excess profits credit and adjustments of X Corporation closely follow those for Lewyt Corporation contained in the record.

Year Ended September 30, 1944

Schedule 2

Computation of Income Tax

	1943 Law	1944 Law
Average net income (Schedule 1)	$187,385.86	$187,385.86
Less income subject to excess profits tax	140,474.82	135,474.82
Income subject to normal and surtax	$ 46,911.04	$ 51,911.04

Normal tax ($4,250.00 plus 31% of $21,911.04)	$ 11,042.42	
(24% of $51,911.04)		$ 12,458.65
Surtax ($2,500.00 plus 22% of $21,911.04)	7,320.43	
(16% of $51,911.04)		8,305.77
Tota' normal and surtax	$ 18,362.85	$ 20,764.42

II

Income tax for each period:	
At 1943 rates (92/366 of $18,362.85)	$ 4,615.80
At 1944 rates (274/366 of $20,764.42)	15,544.95
Income tax for fiscal year 1944	$ 20,160.75

Schedule 3

Computation of Excess Profits Tax

Average net income		$187,385.86	$187,385.86
Plus 50% of interest on borrowed capital		10,172.09	10,172.09
Average excess profits net income		$197,557.95	$197,557.95
Less:			
Specific exemption	$ 5,000.00 $10,000.00		
Excess profits credit	$52,083.13 $52,083.13	$ 57,083.13	$ 62,083.13
Income subject to excess profits tax		$140,474.82	$135,474.82
Excess profits tax (90% of $140,474.82; 95% of $135,474.82)		$126,427.34	$128,701.08
Surtax net income computed without Sec. 26(e) credit		$187,385.86	$187,385.86
80% of $187,385.86		$149,908.69	$149,908.69
Less income tax		$ 18,362.85	$ 20,764.42

Excess profits tax as limited	$131,545.84	$129,144.27
Applicable excess profits tax	$126,427.34	$128,701.08
Amount brought forward	$126,427.34	$128,701.08
Tax for period in 1943 (92/366 of $126,427.34)		$ 31,779.55
Tax for period in 1944 (274/366 of $128,701.08)		$ 96,349.99
Excess profits tax		$128,129.54
Less 10% post war credit		12,812.95
Excess profits tax liability		$115,316.59

Year Ended September 30, 1945

Schedule 4

Computation of Income Tax

Average net income (Schedule 1)	$187,385.86
Less net long term capital gain	10,321.38
Ordinary net income	$177,064.48
Less income subject to excess profits tax	133,731.45
Income subject to normal and surtax	$ 43,333.03
Normal tax ($4,250.00 plus 31% of $18,333.03)	$ 9,933.24
Surtax ($2,500.00 plus 22% of $18,333.03)	6,533.27
25% of net long term capital gain of $10,321.38	2,580.35
Income tax	$ 19,046.86

Schedule 5

Computation of Excess Profits Tax

Average net income (Schedule 1)		$187,385.86
Plus 50% of interest on borrowed capital		11,262.18
Average excess profits net income		$198,648.04
Less:		
Specific exemption	$10,000.00	
Excess profits credit	54,916.59	$ 64,916.59
Income subject to excess profits tax		$133,731.45
95% of $133,731.45		$127,044.88

Surtax net income computed without Sec. 26(e) credit	$187,385.86
80% of $187,385.86	$149,908.69
Less income tax	19,046.86
Excess profits tax as limited by the 80% computation	$130,861.83
Applicable excess profits tax	$127,044.88
Less 10% post war credit	12,704.49
Excess profits tax liability	$114,340.39

Year Ended September 30, 1946

Schedule 6

Computation of Income Tax

	1945 Law	1946 Law
Average net income (Schedule 1)	$187,385.86	$187,385.86
Less income subject to excess profits tax	138,759.23	-0-
Income subject to normal and surtax	$ 48,626.63	$187,385.86
Normal tax:		
Under 1945 law ($4,250.00 plus 31% of $23,626.63)	$ 11,574.26	
Under 1946 law (24% of $187,385.86)		$ 44,972.61
Surtax:		
Under 1945 law ($2,500.00 plus 22% of $23,626.63)	7,697.86	
Under 1946 law (14% of $187,385.86)		26,234.02
Total normal and surtax	$19,272.12	$ 71,206.63
Income tax for each period:		
Tax for period in 1945 (92/365 of $19,272.12)		$ 4,857.63
Tax for period in 1946 (273/365 of $71,206.63)		53,258.66
Income tax for fiscal year 1946		$ 58,116.29

Schedule 7

Computation of Excess Profits Tax

Average net income		$187,385.86
Plus 50% of interest on borrowed capital		8,076.26
Average excess profits net income		$195,462.12
Less:		
Specific exemption	$10,000.00	
Excess profits credit	46,702.89	$ 56,702.89
Income subject to excess profits tax		$138,759.23
Tentative excess profits tax (95% of $138,759.23)		$131,821.27
Surtax net income computed without Sec. 26(e) credit		$187,385.86
80% of $187,385.86		149,908.69
Less income tax		19,272.12
Excess profits tax as limited by 80% computation		$130,636.57
Tentative excess profits tax (smaller of $131,821.27 or $130,636.57)		$130,636.57
Excess profits tax for excess profits tax period (92/365 of $130,636.57)		$ 32,927.57
Less 10% post war credit		3,292.76
Excess profits tax		$ 29,634.81

Year Ended September 30, 1947

Schedule 8

Computation of Income Tax

Average net income	$187,385.86
Less net long term capital gain	3,300.00
Ordinary net income	$184,085.86

Normal tax (24% of $184,085.86)	$ 44,180.61
Surtax (14% of $184,085.86)	25,772.02
25% of net long term capital gain of $3,300.00	$ 825.00
Income tax	$ 70,777.63

Example 2

Illustration of Tax Effect of Contrasting Contentions of Taxpayer and Government With Respect to Computation of Net Operating Loss Under Section 122(a) and (d)(6).

In each of the years 1942 to 1945 the excess profits tax was in effect. A Corporation and B Corporation are taxpayers on the accrual basis. Assume each has an excess profits credit for each year of $45,000.

TAXPAYER A CORPORATION

Year	*Net Income*	*Total tax according to Gov't's contention*	*Total tax applying Lewyt's contention*
1942	740,000	380,000	—0—
1943	775,000	—0—	—0—
1944	(200,000)	—0—	—0—
1945	(775,000)	—0—	—0—
Aggregate	$540,000	$380,000	—0—

TAXPAYER B CORPORATION

Year	*Net Income*	*Total Tax*
1942	135,000	88,850.00
1943	135,000	88,850.00
1944	135,000	90,400.00
1945	135,000	90,400.00
Aggregate	$540,000	$358,500.00

SCHEDULE 1

Computation of Income and Excess Profits Tax for 1942 for A Corporation According to Government's Contention

1. Net Income (prior to sec. 26(e) credit and carryback of 1944 net operating loss)		$740,000.00
2. Less:		
1944 net operating loss..	$200,000.00	
Adjusted excess profits net income (line 9 below)..	400,000.00	600,000.00
3. Normal tax net income....		$140,000.00
4. Normal tax — 24%.....		33,600.00
5. Surtax — 16%.....		22,400.00
6. Income tax		$ 56,000.00
7. Excess profits net income (line 1 above)		$740,000.00
8. Less:		
Specific exemption	$ 5,000.00	
Excess profits credit for 1942	45,000.00	
Excess profits credit for 1943	45,000.00	
Excess profits credit for 1944	45,000.00	
Net operating loss for 1944	200,000.00	340,000.00
9. Adjusted excess profits net income		$400,000.00

10. 90% of $400,000.00		$360,000.00
11. Computation of the 80% limitation:—		
12. Surtax net income (after carryback but prior to sec. 26(e) credit)	$540,000.00	
13. 80% of $540,000.00	432,000.00	
14. Less: Chapter I income tax (line 6 above)	56,000.00	
15. Limitation of excess profits tax	$376,000.00	
16. Excess profits tax (lesser of $376,000.00 and $360,000.00)		$360,000.00
17. Less: Post war credit....		36,000.00
18. Net excess profits tax....		$324,000.00

SCHEDULE 2

Computation of Income and Excess Profits Tax for 1942 for A Corporation According to Taxpayer Lewyt's Contention

1. Net income (prior to sec. 26(e) credit and carryback of 1944 net operating loss)		$740,000.00
2. Less: 1944 net operating loss	$200,000.00	
1943 excess profits tax paid in 1944 (line 13 below)	540,000.00	740,000.00
3. Normal tax net income...		—0—
4. Income tax		—0—
5. Excess profits tax.....		—0—

Computation of 1943 excess profits tax paid in 1944
(before carryback of 1945 net operating loss)

6. Excess profits net income for 1943 before carryback		$775,000.00
7. Less:		
Specific exemption	$ 5,000.00	
Excess profits credit	45,000.00	50,000.00
8. Adjusted excess profits net income		$725,000.00
9. 90% of $725,000.00		$652,500.00
10. Computation of the 80% limitation Surtax net income (prior to sec. 26(e) credit)	$775,000.00	
80% of $775,000.00	620,000.00	
Less: Chapter I income tax	20,000.00	
Limitation of excess profits tax	$600,000.00	
11. Excess profits tax for 1943 (lesser of $652,500.00 and $600,000.00)		$600,000.00
12. Less: Post war credit		60,000.00
13. Net excess profits tax		$540,000.00

SCHEDULE 3

Computation of Income and Excess Profits Tax for 1943 for A Corporation According to the Government's Contention

1. Net income (prior to sec. 26(e) credit and carryback of 1945 net operating loss)	$775,000.00
2. Less: 1945 net operating loss	775,000.00
3. Normal tax net income	—0—
4. Income tax	—0—
5. Excess profits net income (line 1 above)	$775,000.00
6. Less: 1945 net operating loss	775,000.00

7. Adjusted excess profits net income.....	—0—
8. Excess profits tax	—0—

Schedule 4

Computation of Income and Excess Profits Tax for 1942 for B Corporation (Same Computation for 1943)

1. Net Income (prior to sec. 26(e) credit)		$135,000.00
2. Less: Adjusted excess profits net income (line 9 below)		85,000.00
3. Normal tax net income		$ 50,000.00
4. Normal tax—24%		12,000.00
5. Surtax—16%		8,000.00
6. Income tax		20,000.00
7. Excess profits net income (line 1 above)		$135,000.00
8. Less:		
Specific exemption	$ 5,000.00	
Excess profits credit	45,000.00	50,000.00
9. Adjusted excess profits net income		$ 85,000.00
10. 90% of $85,000.00		$ 76,500.00
11. Computation of the 80% limitation:—		
Surtax net income (prior to sec. 26(e) credit)	$135,000.00	
80% of $135,000.00	108,000.00	
Less: Chapter I income tax (line 6 above)	20,000.00	
Limitation of excess profits tax	$ 88,000,00	
12. Excess profits tax (lesser of $88,000.00 and $76,500.00)		$ 76,500.00
13. Less: Post war credit		7,650.00
14. Net excess profits tax		$ 68,850.00

Schedule 5

Computation of Income and Excess Profits Tax for 1944 for B Corporation (Same Computation for 1945)

1. Net income (prior to sec. 26(e) credit)		$135,000.00
2. Less: Adjusted excess profits net income (line 9 below)		80,000.00
3. Normal tax net income		$ 55,000.00
4. Normal tax—24%		13,200.00
5. Surtax—16%		8,800.00
6. Income tax		22,000.00
7. Excess profits net income (line 1 above)		$135,000.00
8. Less:		
Specific exemption	$ 10,000.00	
Excess profits credit	45,000.00	55,000.00
9. Adjusted excess profits net income		$ 80,000.00
10. 95% of $80,000.00		$ 76,000.00
11. Computation of the 80% limitation:—		
12. Surtax net income (prior to sec. 26(e) credit)	$135,000.00	
13. 80% of $135,000.00	108,000.00	
14. Less: Chapter I income tax (line 6 above)	22,000.00	
15. Limitation of excess profits tax	$ 86,000.00	
16. Excess profits tax (lesser of $86,000.00 and $76,000.00)		$ 76,000.00
17. Less: Post War credit		7,600.00
18. Net excess profits tax		$ 68,400.00

Example 3

Additional Illustration of Tax Effect of Contrasting Contentions of Taxpayer and Government With Respect to Computation of Net Operating Loss Under Section 122(a) and (b)(6).

This example differs from example 2 in that the taxes are computed for the years 1944 to 1947, the years involved in the Lewyt case. The excess profits tax was not imposed in 1946 and 1947. C Corporation and D Corporation are on the accrual basis. Assume each has an excess profits credit for each year of $70,000.

TAXPAYER C CORPORATION

Year	*Net Income*	*Total Tax According to Govt.'s Contention*	*Total Tax Applying Lewyt's Contention*
1944	650,000	284,650	—0—
1945	665,000	—0—	—0—
1946	(200,000)	—0—	—0—
1947	(665,000)	—0—	—0—
Aggregate	$450,000	$284,650	—0—

TAXPAYER D CORPORATION

Year	*Net Income*	*Total Tax*
1944	112,500	59,787.50
1945	112,500	59,787.50
1946	112,500	42,750.00
1947	112,500	42,750.00
Aggregate	$450,000	$205,075.00

SCHEDULE 1

Computation of Income and Excess Profits Tax for 1944 for C Corporation According to Government's Contention

1. Net income (prior to sec. 26(e) credit and carry-back of 1946 net operating loss)		$650,000.00
2. Less:		
1946 net operating loss	$200,000.00	
Adjusted excess profits net income (line 9 below)	230,000.00	430,000.00
3. Normal tax net income...		220,000.00
4. Normal tax — 24%.....		52,800.00
5. Surtax — 16%.....		35,200.00
6. Income tax		$ 88,000.00
7. Excess profits net income (line 1 above)		$650,000.00
8. Less:		
Specific exemption	$ 10,000.00	
Excess profits credit for 1944.....	70,000.00	
Excess profits credit for 1945.....	70,000.00	
Excess profits credit for 1946.....	70,000.00	
Net operating loss for 1946	200,000.00	420,000.00
9. Adjusted excess profits net income		230,000.00
10. 95% of $230,000.00.....		218,500.00
11. Computation of the 80% limitation:—		
12. Surtax net income (after CB but prior to sec. 26(e) credit)	$450,000.00	

13. 80% of $450,000.00	360,000.00	
14. Less: Chapter I income tax (line 6 above)	88,000.00	
15. Limitation of excess profits tax	$272,000.00	
16. Excess profits tax (lesser of $272,000.00 and $218,500.00)		$218,500.00
17. Less: Post war credit.....		21,850.00
18. Net excess profits tax....		$196,650.00

SCHEDULE 2

Computation of Income and Excess Profits Tax for 1944 for C Corporation According to Taxpayer Lewyt's Contention

1. Net income (prior to sec. 26(e) credit and carryback of 1946 net operating loss)		$650,000.00
2. Less: 1946 net operating loss	$200,000.00	
1945 excess profits tax paid in 1946 (line 13 below)	450,000.00	650,000.00
3. Normal tax net income		—0—
4. Income tax		—0—
5. Excess profits tax		—0—

Computation of 1945 excess profits tax paid in 1946 (before carryback of 1947 net operating loss)

6. Excess profits net income for 1945 before carryback		$665,000.00
7. Less:		
Specific exemption	$10,000.00	
Excess profits credit	70,000.00	80,000.00
8. Adjusted excess profits net income		$585,000.00
9. 95% of $585,000.00		555,750.00
10. Computation of the 80% limitation:—		
Surtax net income (prior to sec. 26(e) credit)	$665,000.00	

80% of $665,000.00	532,000.00	
Less: Chapter I income tax	32,000.00	
Limitation of excess profits tax	$500,000.00	
11. Excess profits tax for 1945 (lesser of $555,750.00 and $500,000.00		$500,000.00
12. Less: Post war credit		50,000.00
13. Net excess profits tax		$450,000.00

SCHEDULE 3

Computation of Income and Excess Profits Tax for 1945 for C Corporation According to Government's Contention

1. Net income (prior to sec. 26(e) credit and carryback of 1947 net operating loss)	$665,000.00
2. Less: 1947 net operating loss	665,000.00
3. Normal tax net income	—0—
4. Income tax	—0—
5. Excess profits net income (line 1 above)	$665,000.00
6. Less: 1947 net operating loss	665,000.00
7. Adjusted excess profits net income	—0—
8. Excess profits tax	—0—

SCHEDULE 4

Computation of Income and Excess Profits Tax for 1944 for D Corporation (Same Computation for 1945)

1. Net income (prior to sec. 26(e) credit)	$112,500.00
2. Less: Adjusted excess profits net income (line 9 below)	32,500.00
3. Normal tax net income	80,000.00
4. Normal tax—24%	19,200.00
5. Surtax—16%	12,800.00
6. Income tax	$32,000.00
7. Excess profits net income (line 1 above)	$112,500.00

8. Less:		
Specific exemption	$10,000.00	
Excess profits credit	70,000.00	80,000.00
9. Adjusted excess profits net income		$32,500.00
10. 95% of $32,500.00		30,875.00
11. Computation of the 80% limitation:—		
Surtax net income (prior to sec. 26(e) credit)	$112,500.00	
80% of $112,500.00	90,000.00	
Less: Chapter I income tax (line 6 above)	32,000.00	
Limitation of excess profits tax	$58,000.00	
12. Excess profits tax (lesser of $58,000.00 and $30,875.00)		$30,875.00
13. Less: Post war credit		3,087.50
14. Net excess profits tax		$27,787.50

SCHEDULE 5

Computation of Income Tax for 1946 for D Corporation
(Same Computation for 1947)

1. Normal tax net income	$112,500.00
2. Normal tax—24%	27,000.00
3. Surtax—14%	15,750.00
4. Income tax	$42,750.00

Example 4

Computation of taxpayer's 1946 and 1947 net operating loss carry-overs to 1948 and 1949

(Application of taxpayer's contentions to Section 122(b)(2))

1947 net operating loss	$ 786,383.25*		
1946 net operating loss	1,025,444.42		
Total net operating loss available for carry-over to 1948			$1,811,827.67
Less: 1944 income as adjusted (see p. 29, *supra*)			—0—
Less: 1945 net income (R. 10-11)	1,069,252.50*		
Less: 1944 excess profits tax reported by taxpayer paid in 1945 (Sec. 122(b)(2))	510,939.23 (R. 24)		558,313.27
Net operating loss carry-over to 1948			$1,253,514.40

Accepting taxpayer's contentions and applying the same formula, this carry-over restricted to the amount of $786,383.25 (due to the two-year limitation on carry-overs) would be available for carry-over to 1949.

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* The figures used are those contained in the record, stated in the Commissioner's deficiency determination and found by the Tax Court. Disallowance of the interest deduction of $55,949.04 for 1947 (fn. 3, *supra*, p. 4 and resulting minor adjustments would effect roughly proportionate changes, but not the principle applicable or the approximate amounts. Thus, the carry-over to 1948 would then be $1,187,243.98.

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